No. 87-616

In the Supreme Court of the United States

OCTOBER TERM, 1987

HUBERT PARK BECK, DOROTHY FAHS BECK, ROBERT J. BECK and OTTO WEINMANN,
Petitioners,

vs.

MANUFACTURERS HANOVER TRUST COMPANY; MILBANK, TWEED, HADLEY & McCLOY; KELLEY DRYE & WARREN; DONALD B. HERTERICH; ISAAC SHAPIRO; and EDWARD ROBERTS, III,
Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

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QUESTION PRESENTED

Whether, after holding that the defendants had engaged in a "pattern of racketeering activity" under the RICO statute, the Second Circuit was correct in affirming the dismissal of plaintiffs' amended complaint on the ground that the defendants' association-in-fact, which performed all of the predicate acts constituting the "pattern," lacked sufficient continuity to constitute an "enterprise" under RICO.

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Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioners respectfully pray that a writ of certiorari issue to review the order of the United States Court of Appeals for the Second Circuit, entered on July 14, 1987, which on petition for rehearing affirmed a judgment of the United States District Court for the Southern District of New York dismissing petitioners' amended complaint,

brought under the Racketeer Influenced and Corrupt Organizations Act ("RICO").

OPINIONS BELOW

The opinion of the District Court, holding that plaintiffs had not adequately pled "racketeering activity" or a "pattern of racketeering activity" under RICO, is reported at 645 F. Supp. 675 (S.D.N.Y. 1986), and is reproduced as Appendix A. The opinion of the District Court on reargument, affirming its original decision, is reported at 650 F. Supp. 48 (S.D.N.Y. 1986) and reproduced as Appendix C. The opinion of the Court of Appeals, reversing the District Court on both the issues of "racketeering activity" and "pattern," but affirming its judgment on the ground that plaintiffs had not adequately pled a RICO "enterprise," is reported at 820 F. 2d 46 (2d Cir. 1987) and reproduced as Appendix D.

JURISDICTION OF THIS COURT

On June 1, 1987 the Clerk of the Circuit Court entered an order affirming the judgment of the District Court dismissing the amended complaint. On July 14, 1987 she entered an order denying plaintiffs' petition for rehearing, which contained a suggestion that the appeal be reheard *en banc*. These orders are reproduced, respectively, as Appendix E and Appendix F. This petition is filed pursuant to 28 U.S.C. §1254(1), within the time permitted by 28 U.S.C. §2101(c) and Rule 29.1 of this Court.

STATUTES

The statutes involved are U.S.C. §§1961 and 1962, the first two sections of RICO. They are reproduced as Appendix G.

.STATEMENT OF THE CASE

This action was instituted in the United States District Court for the Southern District of New York under RICO, 18 U.S.C. § 1961 *et seq*. Plaintiffs are holders of two series of bonds that were issued by National Railroad Company of Mexico in 1902, and secured by collateral held in an indenture trust by defendant Manufacturers Hanover Trust Company ("Manufacturers") as trustee. Defendant Kelley Drye & Warren ("Kelley") was counsel to Manufacturers as trustee during the period relevant to this action; defendant Milbank, Tweed, Hadley & McCloy ("Milbank") was and is counsel to the United States of Mexico ("Mexico"), recognized by Manufacturers as the holder of more than ninety percent of the face amount of each series of the bonds.

The individual defendants are the representatives of Manufacturers, Kelley, and Milbank who were charged with primary responsibility for matters growing out of the administration of the indenture trust.

Plaintiffs' amended complaint alleges that the defendants defrauded plaintiffs, other individual bondholders, and Mexico of a vast fortune in three phases of unlawful activity relating to the administration of the indenture trust. The RICO predicate acts alleged involve violations of 18 U.S.C. §1341 (relating to mail fraud), and 18 U.S.C. §1343 (relating to wire fraud). The phases of unlawful activity alleged included the following:

(i) Phase I: the defrauding of plaintiffs and similarly situated holders of Prior Lien Bonds by unlawfully treating Mexico as a holder of those bonds with respect to seven distributions of accrued interest from April 1, 1972 through December 31, 1981. Through this treatment defendants wrongfully permitted more than ninety percent of each such distribution to be siphoned off to Mexico, to the detriment of plaintiffs and other individual holders of Prior Lien Bonds.

(ii) Phase II: the defrauding of plaintiffs and similarly situated holders of both series of bonds of substantially the entire value of the collateral held by Manufacturers as indenture trustee through (a) the sale of the collateral at a fraudulently low price, and (b) the treatment of Mexico as a bondholder entitled to 95.83% of the fraudulently low proceeds of the sale.

(iii) Phase III: the defrauding of the government and people of Mexico of their purported share of the proceeds of the sale of the collateral through (a) the sale of the collateral at a fraudulently low price; (b) the failure to disclose to the government of Mexico that it was being defrauded by corrupt Mexican nationals, some of whom were government officials, and that Mexico could have appeared at the sale and purchased the collateral for little or no cash outlay; and (c) the acceptance from the purchaser by Manufacturers, in payment of 95.83% of the sale price, of a fraudulent and legally ineffective assignment, given without consideration, of Prior Lien Bonds previously recognized by Manufacturers as validly held by Mexico.

Phase I spanned 9-1/2 years. Phase II, from its planning in the 1970's to its conclusion at the closing of the sale of collateral, on November 29, 1982, spanned at least three years. Phase III, which began sometime during 1982 and

ended with the sale of collateral, lasted at least several months.

The District Court Decision

Defendants moved to dismiss the amended complaint (i) pursuant to Fed. R. Civ. P. 12(b)(6) for failure, on numerous grounds, to state a claim under RICO; (ii) pursuant to Fed. R. Civ. P. 9(b) for failure to plead fraud with particularity; and (iii) because the action was barred by the applicable statute of limitations. The motion also demanded costs and attorneys' fees under Fed. R. Civ. P. 11 and 28 U.S.C. §1927.

The District Court held that the action was timely instituted, 645 F. Supp. at 679, and that defendants were not entitled to sanctions. *Id.* at 685. However, it dismissed the amended complaint on the alternative grounds that plaintiffs had not adequately pled racketeering activity, *Id.* at 680-83, or a pattern of racketeering activity, *Id.* at 683-85, as required by RICO.

With respect to the issue of racketeering activity the District Court held that the misrepresentations alleged in Phase I were "immaterial as a matter of law," *Id.* at 681, and that while the allegations of Phases II and III satisfied both Rule 12(b)(6) and the "particularity" requirement of the first part Rule 9(b), those allegations did not satisfy, with respect to scienter, the second requirement of Rule 9(b)—that "malice, intent, knowledge, and other condition of mind ... may be alleged generally." *Id.* at 682-83.

Plaintiffs subsequently moved the District Court for reargument and reversal of its decision. The District Court granted the motion for reargument, but affirmed its

prior opinion in all respects. 650 F. Supp. 48 (S.D.N.Y. 1986).

The Circuit Court Decision

On the issue of racketeering activity the Second Circuit affirmed the holding of the District Court with respect to Phase I, but reversed as to Phases II and III. 820 F. 2d at 50.

On the issue of "pattern" the Second Circuit reversed the District Court, holding that while Phases II and III constituted, in the aggregate, a single episode of racketeering activity, the Second Circuit rule is that two related predicate acts constituting a single such episode are sufficient to establish a "pattern" under RICO. *Id.* at 51.

If the Second Circuit had stopped at this point, it would have reinstated the amended complaint with respect to Phases II and III, and sent the case back to the District Court for discovery and trial. However, the Circuit Court went on to affirm the District Court's judgment on a ground completely outside the ambit of that Court's opinion: that while the defendants had engaged in a pattern of racketeering activity, their association-in-fact enterprise, which committed the "pattern", lacked the continuity necessary for an "enterprise" within the meaning of RICO. Specifically, the Second Circuit held that, because the enterprise ceased to function at the conclusion of the sale of the collateral, it could not be a RICO enterprise. *Id.* at 51-2.

REASONS FOR ALLOWANCE OF THE WRIT

This case grows out of the burgeoning "pattern"

litigation engendered by footnote 14 in this Court's opinion in *Sedima, S.P.R.L. v. Imrex Company, Inc.*, 473 U.S. 479, 105 S. Ct. 3275 (1985).

Since *Sedima*, ten of the twelve Circuit Courts have struggled with the concept of "pattern" and have adopted rules that are not only in mutual conflict, but that in several cases are internally inconsistent. Moreover, the rules of the Second and Fifth Circuits, in which "pattern" litigation has segued into "pattern/enterprise" litigation, are grossly violative of the RICO statute and substantially transcend the possible limits of any mandate on the interpretation of "pattern" suggested by this Court in footnote 14. As a result, the decision in any particular RICO case is almost totally dependent on which Circuit it happens to be filed in, and on which of its rules any particular Circuit decides to apply.

In the interests of (i) the fostering of uniformity of decision among the Circuits, (ii) the preservation of the integrity of the RICO statute and the maintenance of this Court's intended limits on the interpretation of footnote 14, and (iii) the promotion of justice through the uniform treatment of litigants within the respective Circuits, it is respectfully submitted that this Court should grant this petition for certiorari and prescribe a single standard for any future pattern/enterprise litigation.

In order to demonstrate the disparity of the pattern/enterprise rules among the Circuits and the extent to which some of them controvert RICO and *Sedima* or are internally inconsistent, the rules of the ten Circuits that have adopted "pattern" or "pattern/enterprise" rules will be briefly adverted to below. Only the District of Columbia and Sixth Circuits have as yet not adopted any such rules.

First Circuit

In its only "pattern" decision the First Circuit held that the payment of a bribe by a corporation did not constitute a "pattern," even though the bribe had been paid in three installments and had included eleven telephone calls and eight letters that were alleged as "racketeering activity" within the meaning of 18 U.S.C. §1961(1). *Roeder v. Alpha Industries, Inc.*, 814 F. 2d 22, 31-32 (1st Cir. 1987). Because the Court viewed the three installments as a single bribe, it declined to definitively rule on whether a "pattern" must be predicated on racketeering activity involving more than a single scheme or episode, *cf. Superior Oil Co. v. Fulmer*, 785 F. 2d 252, 257 (8th Cir. 1986), but the Court was implicitly critical of the *Superior Oil* decision.

Second Circuit

The Second Circuit has adopted a very liberal view of "pattern," expressly rejecting the "multiple schemes" or "multiple episodes" tests, and requiring only two related predicate acts for the establishment of a pattern. *United States v. Ianniello*, 808 F. 2d 184, 192 (2d Cir. 1986). In enunciating the rule the Ian*niello* Court explicitly relied on *United States v. Weisman*, 624 F. 2d 1118 (2d Cir.), *cert. denied*, 449 U.S. 871 (1980), which predicated the existence of a pattern on the concept of "enterprise" and the ten-year limitation set forth in §1961(5). *Ianniello, supra*, 808 F. 2d at 190.

The teaching of *Ianniello* and *Weisman* is thus that we must first look to "enterprise" to determine whether there has been a "pattern"; under those cases the finding of a pattern is conclusively determinative of the existence of RICO enterprise. It is a contradiction in terms, under those decisions, to say that there was a pattern of racketeering activity but no RICO enterprise that

committed it. Nevertheless, that is precisely what the Second Circuit held in the instant case, for which certiorari is sought. 820 F. 2d at 51-2.

In engrafting "pattern" considerations onto the concept of "enterprise" the instant case is not only inconsistent with *Ianniello* and *Weisman*, but is also inconsistent with the RICO statute and with this Court's opinion in *Sedima*. Of all the terms set forth in 18 U.S.C. §1961 only "pattern of racketeering activity" is defined in such a way as to fairly permit the judicial engraftment of considerations of quantity or of temporal interpretation. As this Court stated in footnote 14 of *Sedima*, "... the definition of a 'pattern of racketeering activity' *differs from the other provisions of §1961* in that it states that a pattern 'requires at least two acts of racketeering activity,' §1961(5) (emphasis added), not that it 'means' two such acts ...." 105 S. Ct. at 3285 (italics supplied).

In applying "pattern" considerations to "enterprise" the Second Circuit thus violated the definition of enterprise in §1961(4) and transcended the boundary of the mandate of footnote 14 of *Sedima*. Nonetheless, in the recent case of *Furman v. Cirrito*, No. 86-7283, slip op. (2d Cir. September 1, 1987), the Second Circuit reaffirmed the approach it took in the instant case. (The text of the *Furman* opinion is reproduced at Appendix H.) In his dissent in Furman, Judge Pratt stated:

> While the majority here motors past *Ianniello* with hardly a glance in the rear view mirror, another panel's recent opinion in *Beck v. Manufacturers Hanover Trust Co.*, 820 F. 2d 46 (2d Cir. 1987), rides right over it. There the court acknowledged that *Ianniello* rejects any requirement of multiple episodes to allege a "pattern of racketeering activity"; in the next

> breath, however, it brought the multiple-episode concept back to life by engrafting it onto the "enterprise" requirement. The *Beck* court defined "enterprise" as the racketeering episode allegedly engaged in by the defendants, rather than as what the statute describes: the organizational vehicle by or through which the racketeering activity is undertaken. *See United States v. Turkette*, 452 U.S. 576, 583 (1981) ("The 'enterprise' is not the 'pattern of racketeering activity'; it is an entity separate and apart from the pattern of activity in which it engages."). RICO's plain language makes it improper to conflate "continuing enterprise" and "racketeering activity". By equating "enterprise" with "racketeering activity" and then requiring multiple episodes in order to make the enterprise a "continuing enterprise" *Beck* appears to defer to the authority of *Ianniello*. Realistically, however, *Beck* undercuts *Ianniello* by putting back into the RICO stew the multiple-episode ingredient that *Ianniello* sought to remove. Slip op. at 5005-06; Appendix H at 68A-9A.

From the foregoing it is clear that the Second Circuit's decision in the instant case is not only in conflict with §1961(4) and footnote 14 of *Sedima*, but is also inconsistent with the Second Circuit's previous decisions in *Ianniello* and *Weisman*. As will also be clear, it is inconsistent with the rules enunciated by other Circuit Courts on "pattern/enterprise."

Third Circuit

While the Third Circuit has expressly declined to enunciate a definitive "pattern" rule, the cases that have

been decided thus far indicate that that Court is moving toward a position between that of the most liberal decisions, *cf. United States v. Ianniello, supra; R.A.G.S. Couture, Inc. v. Hyatt*, 774 F. 2d 1350, 1355 (5th Cir. 1985), and the most restrictive, *cf. Superior Oil Co. v. Fulmer, supra. See, United States v. Grayson*, 795 F. 2d 278, 288-90 (3rd Cir. 1986) ("the predicate acts relied upon to support a conviction under RICO must 'have the same or similar purposes, results, participants, victims, or methods of commission, or [must be] otherwise ... interrelated by distinguishing characteristics,' so as not to be 'isolated events'", *citing Sedima*, 105 S. Ct. at 3285 n. 14); *Petro-Tech, Inc. v. Western Co. of North America*, 824 F. 2d 1349, 1354-55 (3rd Cir. 1987) (distinguishing *Superior Oil* on the facts); *Malley-Duff & Associates v. Crown Life Ins. Co.*, 792 F. 2d 341, 354 (3rd Cir. 1986), *aff'd*, ___ U.S. ___, 107 S. Ct. 2759 (1987).

Fourth Circuit

The Fourth Circuit has enunciated a "case-by-case" rule for pattern, ostensibly similar to that of the Seventh Circuit (*infra*). *HMK Corp. v. Walsey*, No. 86-3582, slip op. at 8, 12-13 (4th Cir. September, 17, 1987); *International Data Bank, Ltd. v. Zepkin*, 812 F. 2d 149, 154 (4th Cir. 1987). (The text of the *HMK* opinion is reproduced as Appendix K.)

But the opinions in *HMK* and *International Data Bank*, in both of which no "pattern" was found, indicate that the application of the rule by the Fourth Circuit will be considerably more restrictive than that of the Seventh.

Fifth Circuit

The Fifth Circuit, like the Second Circuit in *U.S. v. Ianniello, supra*, adopted in its first post-*Sedima* decision

the most liberal possible reading of "pattern"—that two related predicate acts committed in the course of a single fraudulent scheme are sufficient. *R.A.G.S. Couture, Inc. v. Hyatt*, 774 F. 2d 1350, 1355 (5th Cir. 1985).

Two subsequent decisions appeared to pull back from this position. *Smoky Greenhaw Cotton v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 785 F. 2d 1274, 1280 n. 7 (5th Cir. 1986) (nature of pattern requirement still an open question); *Cowan v. Corley*, 814 F. 2d 223, 226-27 (5th Cir. 1987) ("We read ... *Sedima* to direct a narrower definition of pattern than had been sometimes employed").

Finally, in *Montesano v. Seafirst Corp.*, 818 F. 2d 423, 426-27 (5th Cir. 1987), the Court, deemed bound by *R.A.G.S. Couture*, found the existence of a "pattern", but then engrafted "pattern" considerations onto "enterprise" and dismissed the complaint for lack of a RICO enterprise. This is precisely the state of the law that exists in the Second Circuit, and, for the reasons set forth above, is inconsistent with both the RICO statute and footnote 14 of *Sedima*.

Seventh Circuit

The Seventh Circuit has ostensibly rejected the restrictive "two schemes" or "two episodes" approach to pattern, and adopted a pragmatic, case-by-case approach. *Morgan v. Bank of Waukegan*, 804 F. 2d 970, 975 (7th Cir. 1986) ("predicate acts must be ongoing over an identified period of time so they can fairly be viewed as constituting separate transactions").

However, growing up alongside *Morgan*, in which a "pattern" was found, is a considerably longer line of cases in which it was not. *Lipin Enterprises v. Lee*, 803 F. 2d 322,

324 (7th Cir. 1986) (distinguished in *Morgan* as a single transaction with multiple predicate acts); *Elliott v. Chicago Motor Club Insurance*, 809 F. 2d 347 (7th Cir. 1987) (several acts of mail fraud committed over a period of several years insufficient for a "pattern"); *Skycom Corp. v. Telstar Corp.*, 813 F. 2d 810 (7th Cir. 1987).

These cases illustrate the major deficiency of a case-by-case approach: the distinctions between Morgan and the "no pattern" cases may be predicated less on objective considerations than on the Court's subjective reaction to the surrounding circumstances and its formulation of the facts. In most of these cases the Court could have come out either way, with tenable opinions written in support of diametrically opposed results.

Eighth Circuit

The Eighth Circuit has formulated, and consistently applied, the most restrictive "pattern" rule of any Circuit. Under that rule predicate acts—regardless of how many—committed in the furtherance of a single fraudulent scheme are insufficient to constitute a "pattern". *Superior Oil Co. v. Fulmer*, 785 F. 2d 252, 257 (8th Cir. 1986); *Holmberg v. Morrisette*, 800 F. 2d 205 (8th Cir. 1986), *cert. denied*, 107 S. Ct. 1953 (1987); *Madden v. Gluck*, 815 F. 2d 1163 (8th Cir. 1987), *petition for cert. filed*, 56 U.S.L.W. 3067 (U.S. June 3, 1987) (No. 86-1923); *Ornest v. Delaware North Companies*, 818 F. 2d 651 (8th Cir. 1987); *Allright Missouri, Inc. v. Billeter*, No. 86-1476, slip op. (8th Cir. September 16, 1987). (The text of the *Allright Missouri* opinion is reproduced as Appendix J.)

In a very recent case, however, two members of an Eighth Circuit panel, while agreeing that the "multiple schemes" rule governs decisions in that Circuit, wrote

concurring opinions indicating their judgment that the rule should be reexamined by the Court *en banc*. *H.J., Inc. v. Northwestern Bell Telephone Co.*, No. 87-5121, slip op. (8th Cir. September 22, 1987). (The text of the opinion is reproduced as Appendix L.)

Ninth Circuit

The Ninth Circuit has adopted a rule that a "pattern" may be predicated on one fraudulent scheme, provided that there is a "threat of continuing activity" on the part of the defendant. The rule appears to require that the defendant's scheme be open-ended, so that but for his having been caught he would have continued the perpetration of the fraud. *TeleVideo Systems, Inc. v. Heidenthal*, No. 86-2129, slip op. (9th Cir. September 2, 1987) (to be published at 826 F. 2d 915; the text of the opinion is reproduced as Appendix I); *Sun Savings & Loan Association v. Dierdorff*, 825 F. 2d 187 (9th Cir. 1987); *Schreiber Distributing Co. v. Serv-Well Furniture Co.*, 806 F. 2d 1393 (9th Cir. 1986).

Tenth Circuit

The Tenth Circuit, like the Ninth, has rejected the "multiple schemes" requirement of the Eighth Circuit, and enunciated a rule that multiple predicate acts committed in connection with a single fraudulent scheme, coupled with a threat of continuing criminal activity, may constitute a "pattern." However, the Tenth Circuit's rule appears to be more circumscribed than the Ninth's: open-ended fraudulent activity involving one scheme and a single victim, even if multi-goaled, may not constitute a "pattern." *See, Condict v. Condict*, 815 F. 2d 579 (10th Cir. 1987); *Torwest DBC, Inc. v. Dick*, 810 F. 2d 925

(10th Cir. 1987).

Eleventh Circuit

The Eleventh Circuit has also adopted a fairly liberal "pattern" rule, expressly rejecting the "multiple schemes" rule of the Eighth Circuit. The Eleventh Circuit rule appears to be of the pragmatic "case-by-case" sort adopted by the Seventh Circuit, with all of its attendant difficulties in factual interpretation. *See, Bank of America v. Touche Ross & Co.*, 782 F. 2d 966, 971 (11th Cir. 1986); *United States v. Watchmaker*, 761 F. 2d 1459, 1475 (11th Cir. 1985).

The Necessity For Review

From the foregoing discussion, it is apparent that the various Circuits have adopted widely divergent—often conflicting— rules regarding "pattern." In the interest of uniformity of result, this Court should now step in to impose order on a chaotic situation.

Moreover, the Second (in the instant case) and Fifth Circuits have violated the RICO statute and transcended the limits of footnote 14 of *Sedima* by appending to the concept of "enterprise" *Sedima's* continuity considerations regarding "pattern". Thus, even absent an attempt to fully rationalize the "pattern" situation, the holding of the Second Circuit in the instant case, and its Fifth Circuit analog, should be reversed.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX A

OPINION OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK BY THE HON. ROBERT W. SWEET, U.S.D.J., DATED SEPTEMBER 30, 1986

HUBERT PARK BECK, DOROTHY FAHS BECK, ROBERT J. BECK and OTTO WEINMANN,

Plaintiffs,

-against-

MANUFACTURERS HANOVER TRUST COMPANY; MILBANK, TWEED, HADLEY & McCLOY; KELLEY DRYE & WARREN; DONALD B. HERTERICH; ISAAC SHAPIRO; and EDWARD ROBERTS, III,

Defendants.

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SWEET, D.J.

In this action brought under the Racketeer Influenced and Corrupt Organizations Act ("RICO"), 18 U.S.C. §1961 *et seq.*, defendants move to dismiss the amended complaint for failure to state a claim under Fed. R. Civ. P. 12(b)(6) and to plead fraud with particularity under Fed. R. Civ. P. 9(b) and because the action is barred by the applicable statute of limitations. In addition, defendants move to recover costs and attorneys' fees pursuant to Fed. R. Civ. P. 11 and 28 U.S.C. §1927. For the following reasons the motion to dismiss is granted, and the motion to recover costs and fees is denied.

Facts

In 1902, the National Railroad Company of Mexico ("National") issued $23,000,000 principal amount 4-1/2% Prior Lien Bonds (the "Prior Lien Bonds") and $27,289,000 First Consolidated Mortgage Bonds (the "Consolidated Mortgage Bonds"). Plaintiffs purportedly hold $1,500 principal amount of Prior Lien Bonds and $153,500 of Consolidated Mortgage Bonds. Defendant Manufacturers Hanover Trust Company ("MHT") is the successor trustee for both series of bonds. The other defendants are Donald B. Herterich ("Herterich"), a senior vice-president of MHT; Kelley Drye & Warren ("Kelley Drye"), counsel to MHT; Edward Roberts III ("Roberts"), a Kelley Drye partner; Milbank, Tweed, Hadley & McCloy ("Milbank"), counsel to Mexico; and Isaac Shapiro ("Shapiro"), a Milbank partner at the time of the events alleged.

National is a Utah corporation which in 1902 owned and operated railway lines in Mexico. National also owned certain railway properties in and around Laredo, Texas (the "U.S. collateral"), which it pledged to the trustee as security for, among other issues, the Prior Lien and Consolidated Mortgage Bonds. The Prior Lien Bonds represented a first mortgage against the U.S. collateral and certain collateral located in Mexico; the Consolidated Mortgage Bonds were subordinated to the Prior Lien bonds.

In 1908, under a plan of readjustment and union, National was taken over by Ferrocarriles Nacionales de Mexico ("Ferrocarriles"), a publicly-owned corporation which owns and operates Mexico's railroads. As a result, Ferrocarriles assumed all of National's liabilities, as well as ownership of National's property, including the U.S. collateral securing the bonds.

The bonds have been in default since 1914. In 1942, Mexico issued a decree ("the Registration Decree") requiring holders of certain Mexico securities, including the Prior Lien and Consolidated Mortgage Bonds, to present their bonds for registration to establish non-enemy ownership. In 1951, Mexico promulgated the "Law on the Fate of Enemy Bonds" under which ownership of all bonds not registered was deemed to be vested as property of Mexico.

Approximately 96% of the issued and outstanding Prior Lien and Consolidated Mortgage Bonds were registered under the Registration Decree. The bonds held by plaintiffs were never registered. Pursuant to a 1946 Debt Readjustment Agreement with the International Committee of Bankers, or through direct purchase from bondholders, Mexico acquired all Prior Lien and Consolidated Mortgage Bonds registered under the Registration

Decree.

Between 1942 and 1981, MHT, as indenture trustee, made numerous distributions of accrued and unpaid interest to holders of Prior Lien Bonds. In these and all other distributions, MHT treated the holders of unregistered bonds (including plaintiffs) as the legal owners of the bonds entitled to receive distributions and treated Mexico as the owner of the approximately 96% of the bonds which Mexico had acquired, notwithstanding plaintiffs' objections that Mexico was not entitled to receive distributions as a bondholder.

MHT read Article Four, Section Five of the Prior Lien Trust Indenture to empower a holder of more than 75% of the issued and outstanding Prior Lien Bonds to instruct MHT to foreclose the Prior Lien Mortgage and sell the collateral securing the bonds. Mexico, as holder of approximately 96% of the Prior Lien Bonds, directed MHT to foreclose on the mortgage and sell the U.S. collateral.

The claims asserted in plaintiffs' complaint are based on alleged wrongdoing in connection with the distribution of interest payments to Mexico between 1942 and 1981 ("Phase I"), the sale of the U.S. collateral ("Phase II"), and the disposition of the proceeds of that sale ("Phase III"). In Phase I, defendants allegedly defrauded plaintiffs and similarly situated holders of Prior Lien Bonds by unlawfully treating Mexico as a holder of those bonds with respect to seven distributions of accrued interest from April 1, 1972 through December 31, 1981. Through this treatment defendants allegedly wrongfully permitted more than ninety percent of each such distribution to be siphoned off to Mexico, to the detriment of plaintiffs and other individual holders of Prior Lien Bonds.

In Phase II, defendants allegedly defrauded plaintiffs and similarly situated holders of both series of bonds by

depriving them of substantially the entire value of the collateral held by MHT as indenture trustee through (a) the sale of the collateral at a fraudulently low price, and (b) the treatment of Mexico as a bondholder entitled to 95.83% of the fraudulently low proceeds of the sale.

In Phase III defendants allegedly defrauded the government and the people of Mexico by depriving them of their purported share of the proceeds of the sale of collateral through (a) the sale of the collateral at a fraudulently low price; (b) the failure to disclose to the government of Mexico that it was being defrauded by corrupt Mexican nationals, some of whom were government officials, and that Mexico could have appeared at the sale and purchased the collateral for little or no cash outlay; and (c) the acceptance by MHT of a fraudulent and legally ineffective assignment from the purchaser, in payment of 95.83% of the sale price, given without consideration of Prior Lien Bonds previously recognized by MHT as validly held by Mexico.

Two prior actions based on these facts are now pending against MHT in the Supreme Court of New York County, *Beck v. Manufacturers Hanover Trust Co.*, No. 12396/83 ("*Beck I*"), and *Beck v. Manufacturers Hanover Trust Co.*, No. 15145/85 ("*Beck II*"). In *Beck I*, plaintiffs allege that MHT breached its fiduciary responsibilities to plaintiffs as bondholders in its administration of the indenture trust. In *Beck II*, plaintiffs allege that MHT breached its fiduciary responsibilities to plaintiffs as bondholders in the conduct of its defense in *Beck I*.

Statute of Limitations

The provisions of RICO providing for a private cause of action contain no statute of limitations within which actions must be commenced. In the absence of a specific

limitations period in a federal statute creating a private right of action, such as the RICO statute, a court must apply the most appropriate relevant federal statute of limitations, and if there is none, the most relevant state limitations period. *Durante Bros. & Sons, Inc. v. Flushing National Bank*, 755 F. 2d 239, 248 (2d Cir.), *cert. denied*, 105 S. Ct. 3530 (1985); *see also Board of Regents v. Tomanio*, 446 U.S. 478, 485 (1980); *Johnson v. Railway Express Agency Inc.*, 421 U.S. 454 (1975). In a RICO action, state law regarding the length of the limitations period applies. *Durante Bros. & Sons Inc. v. Flushing National Bank, supra*, 755 F. 2d at 248.

Because there is no New York state law analogous to RICO, the Second Circuit has held that the three-year statute of limitations in CPLR §214(2) for liabilities created by statute applies. *Durante Bros & Sons Inc. v. Flushing National Bank, supra*, 755 F. 2d at 245; *see also Rand v. Anaconda-Ericsson, Inc.*, 623 F. Supp. 176, 182 n.2 (E.D.N.Y. 1985) (assumes that three-year statute of limitations in CPLR §214(3) [sic] applies to RICO actions involving fraud), *aff'd* 794 F. 2d 843 (2d Cir. 1986); *Teltronics Services Inc. v. Anaconda-Ericsson, Inc.*, 587 F. Supp. 724, 733 (E.D.N.Y. 1984) (applies three-year limitations period to RICO action based on fraud), *aff'd*, 762 F. 2d 185 (2d Cir. 1985). But *see Fustok v. Conticommodity Services, Inc.*, 618 F. Supp. 1076, 1081 (S.D.N.Y. 1985) (In view of perceived ambiguity in *Durante* and practical consideration that case was ready for trial and dismissal would be inefficient, court applies six-year statute of limitations in RICO action grounded in fraud.)

While New York state law determines the length of the limitations period under RICO, federal law determines when a RICO cause of action accrues. *See Robertson v. Seidman & Seidman*, 609 F. 2d 583, 587 (2d Cir. 1979); *IIT v. Cornfeld*, 619 F. 2d 909 (2d Cir. 1980); *Seawell v. Miller Brewing Co.*, 576 F. Supp. 424, 427-28 (M.D.N.C. 1983).

Federal law dictates that a cause of action involving fraud accrues "when the plaintiff has actual knowledge of the alleged fraud or knowledge of facts which in the exercise of reasonable diligence should have led to actual knowledge." *IIT v. Cornfeld, supra,* 619 F. 2d at 929. Courts uniformly have applied the general federal rule for accrual of RICO claims grounded in fraud. *See Compton v. Ide,* 732 F. 2d 1429, 1433 (9th Cir. 1984); *Electronic Relays (India) Pvt., Ltd. v. Pascente,* 610 F. Supp. 648, 653 (N.D. Ill. 1985); *Seawell v. Miller Brewing Co., supra,* 576 F. Supp. at 427-28.

This definition of accrual, however, presupposes that the "fraud" includes injury to the plaintiff. "The general federal rule is that the limitations period begins to run when the plaintiff knows or has reason to know of the injury which is the basis for this action." *Compton v. Ide, supra,* 732 F. 2d at 1433 (emphasis added).

The injury to plaintiffs from the sale of the U.S. collateral occurred on November 29, 1982 — the date on which the sale of collateral was closed and title passed from MHT, as trustee, to Mexrail. Prior to the closing no beneficiary of the trust could have maintained an action for damages; the most a beneficiary could have done was attempt to enjoin the sale. This action was instituted on November 29, 1985, exactly three years after the closing. Therefore, the statute of limitations does not bar this action.

RICO

A private cause of action under RICO is authorized by 18 U.S.C. §1964(c), which permits any person injured "by reason of" a violation of 18 U.S.C. §1962 to recover treble damages and attorney's fees. Section 1962 makes in unlawful to (a) invest income "derived ... from a pattern

of racketeering activity" in an interstate enterprise, (b) acquire or maintain an enterprise "through a pattern of racketeering," (c) participate in the conduct of an enterprise "through a pattern of racketeering," or (d) conspire to violate any of these substantive prohibitions. A "pattern of racketeering activity" is defined in §1961(5) to require commission of at least two crimes listed in §1961(1), including mail fraud (18 U.S.C. §1341) and wire fraud (18 U.S.C. §1343).

The requirements for pleading a RICO claim were set forth by the Court of Appeals for the Second Circuit in *Moss v. Morgan Stanley, Inc.*, 719 F. 2d 5, 17 (2d Cir. 1983), *cert. denied*, 465 U.S. 1025 (1984):

> [t]o state a claim for damages under RICO a plaintiff has two pleading burdens. First, he must allege that the defendant has violated the substantive RICO statute, 18 U.S.C. §1962 (1976), commonly known as "criminal RICO." In doing so, he must allege the existence of seven constituent elements: (1) that the defendant (2) through the commission of two or more acts (3) constituting a "pattern" (4) of "racketeering activity" (5) directly or indirectly invests in, or maintains an interest in, or participates in (6) an "enterprise" (7) the activities of which affect interstate or foreign commerce. 18 U.S.C. §1962(a)-(c) (1976). Plaintiff must allege adequately defendant's violation of section 1962 before turning to the second burden — i.e., invoking RICO's civil remedies of treble damages, attorney's fees and costs [citations omitted]. To satisfy this latter burden, plaintiff must allege that he was "injured in

> his business or property by reason of a violation of section 1962." 18 U.S.C. §1964(c) (1976) (emphasis added).

Accord Sedima, S.P.R.L. v. Imrex Co., 105 S. Ct. 3275, 3285-6 (1985); *Rush v. Oppenheimer & Co.*, 628 F. Supp. 1188, 1192 (S.D.N.Y. 1986). Plaintiffs allege multiple violations of RICO under subsections (a), (b), (c), and (d) of section 1962 against multiple defendants in varying combinations and scenarios.

"Racketeering Activity"

To be liable under RICO, a defendant must engage in a pattern of racketeering activity. 18 U.S.C. §1962(a)-(d). "Racketeering activity" is the violation of one or more enumerated state and federal criminal offences, including mail and wire fraud under 18 U.S.C. §§1341 and 1343. 18 U.S.C. §1961(1).

Plaintiffs rely entirely on allegations of mail and wire fraud to make out the requisite "pattern of racketeering activity" under RICO in each of the ten counts of the amended complaint. Therefore, to sustain this action under RICO, plaintiffs must plead the elements of an indictable offence under the federal mail and wire fraud statutes by showing that each defendant (1) participated in a scheme to defraud, and (2) knowingly used the mails or interstate wires to further the scheme. *E.g., United States v. Gelb*, 700 F. 2d 875, 879 (2d Cir.), *cert. denied*, 464 U.S. 853 (1983).

Furthermore, to prove mail or wire fraud, plaintiffs must show that the scheme was devised with specific intent to defraud, that any nondisclosures or affirmative misrepresentations were material, and, although the scheme's victims need not have in fact been defrauded,

that some actual harm or injury was at least contemplated. *United States v. Bronston*, 658 F. 2d 920, 927 (2d Cir. 1981) (citing *United States v. Von Barta*, 635 F. 2d 999, 1005 n. 24, 1006 (2d Cir. 1980), *cert. denied*, 450 U.S. 998 (1981)), *cert. denied*, 456 U.S. 915 (1982). In addition the statutes are violated when a fiduciary conceals "material information which he is under a duty to disclose to another under circumstances where the non-disclosure could or does result in harm to the other." *United States v. Bronston*, 658 F. 2d 920, 926 (2d Cir. 1981), *cert. denied*, 456 U.S. 915 (1982); *see United States v. Siegel*, 717 F. 2d 9, 14 (2d Cir. 1983).[1]

Plaintiffs need not allege that they were personally defrauded by defendants; rather, they need only allege that they were injured by reason of a scheme to defraud. *See, e.g., SJ Advanced Technology & Mfg. Corp. v. Junkunc*, 627 F. Supp. 572, 575-76 (N.D. Ill. 1986); *Callan v. State Chemical Mfg. Co.*, 584 F. Supp. 619, 623 (E.D. Pa. 1984). Therefore, plaintiffs are not precluded from bringing this action by reason of certain letters from MHT to plaintiffs disclosing its position in administering the Prior Lien Trust or by reason of other knowledge of MHT's activities. Defendants contend, however, that plaintiffs have failed to allege the fraudulent or deceptive nature of any act of omission by defendants.

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[1] Although raised in the pleadings, the issue of whether RICO incorporates the elements of common law fraud is not determinative here. While Second Circuit has not specifically discussed the inclusion of common law fraud in mail and wire fraud cases, the specific requirement of a showing of materiality in *Bronston* carries with it some showing of possible reliance. *See Bronston*, 658 F. 2d at 926 (statutes violated "where non-disclosure could or does result in harm") (emphasis added).

Plaintiffs' complaint alleges a number of misstatements and omissions which it contends were made to defraud (a) the bondholders, other than plaintiffs, who did not tender their bonds in accordance with the 1946 Agreement (the non-assenting bondholders) and (b) Mexico. Plaintiffs allege that the notices mailed and published in connection with the seven interim interest distributions[2] were fraudulent because they implied, falsely, that MHT was a party to the 1946 Agreement and was obligated to distribute interest to the Fiscal Agent of Mexico rather than the non-assenting bondholders. In fact, plaintiffs claim MHT was distributing interest to Mexico as a bondholder rather than under the 1946 Agreement.

The allegation that MHT relied on Mexico's status as a bondholder in making the distributions must be taken as true for purposes of this motion to dismiss the complaint. *See Miree v. DeKalb County*, 433 U.S. 25, 27 n.2 (1977). While the notice clearly states instead that MHT was distributing interest payments "in accordance with the Assignments provided for in Article IX of [the 1946] Agreement," such a misrepresentation is immaterial as a

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[2] Each of the notices contained the following statement:

> In respect of Bonds which have been stamped to indicate assent to the Offer of the United States of Mexico made pursuant to Mexico's agreement with the International Committee of Bankers on Mexico dated February 20, 1946, the amount of such distribution will be paid to the Chase Manhattan Bank, Successor Fiscal Agent of Mexico,in accordance with the assignments provided for in Article IX of said Agreement; and distribution will not be made to the holders of such assenting Bonds. (Emphasis in original of mailed notices only.)

matter of law. All bondholders were fully apprised of the distribution of interest to Mexico or the Fiscal Agent of Mexico, and so no misapprehension as to whom the payment were ultimately being made could have arisen. MHT's inconsistent justifications for making the payment to Mexico could not have induced bondholders to act or refrain from acting, since the only action they might have taken was a lawsuit no different from one they could have brought upon discovery of the "fraud." Furthermore, the bondholders could have simply read the 1946 Agreement for themselves to discover whether MHT could legitimately rely on that document in making the payments. *Cf. Samuelson v. Union Carbide Corp.*, No. 85 Civ. 5373. slip op. at 8 (S.D.N.Y. Jan. 29, 1986) (under New York law, party will not be heard to complain where he has "the means available to him of knowing, by the exercise of ordinary intelligence ... the real quality of the subject of the representation") (quoting *Danann Realty Corp. v. Harris*, 5 N.Y. 2d 317, 322, 184 N.Y.S. 2d 599, 603, 157 N.E. 2d 597 (1959)). From the face of the complaint it is evident that plaintiffs cannot show that the misrepresentation "could or [did] result in harm" to the non-assenting bondholders. *See United States v. Bronston*, 658 F. 2d 920, 926 (2d Cir. 1981), *cert, denied*, 456 U.S. 915 (1982).

The remaining claims of fraud arise out of the alleged improper sale of the U.S. collateral. The amended complaint alleges that (1) MHT intentionally misread Article 4, §5 of the Prior Lien Bond indenture to empower a holder of 75% or more in principal amount of the Prior Lien Bonds to direct a sale and procure its own valuations of the collateral, *see* Amended Complaint ¶¶ 67-80; (2) MHT used the valuations to set the upset price for the sale, ¶82, despite the fact that it and the other defendants knew that the valuation of the owned land was only a fraction of its true worth, ¶89; (3) Shapiro discussed by telephone the valuations of certain items of collateral

without disclosing that each of the valuations substantially understated the value of the property, ¶101-103; (4) the Notice of Sale prepared by defendant (a) failed to inform the Consolidated Mortgage Bond holders of their interest in the sale, ¶109(i) & (ii), (b) set forth a sum due on the Prior Lien Bonds that was less than half the sum actually owing on them, ¶109(III), and (c) failed to disclose that the upset price was based on valuations procured by the Mexican nationals; (5) a notice sent to Prior Lien Bondholders on December 20, 1985 and published by newspaper (a) failed to disclose that the sale price was based on fraudulently understated values of the collateral, (b) stated that the amount of the distribution on the assenting bonds was being made to Chase Manhattan as Fiscal Agent when in fact there was to be no such distribution, and (c) failed to disclose that MHT knew that Mexrail's tender of the bonds was fraudulent, ¶118-123; and (6) defendants, particularly Milbank and Shapiro, fraudulently failed to inform Mexico that it could have bid at the sale and received a credit against the sale price that would have resulted in it having only a fraction of the price to pay in cash. ¶¶128-166.

On the pleadings alone, this court cannot conclude that none of these allegations of misrepresentation and nondisclosure state a claim of fraud as required by Fed. R. Civ. P. 12(b)(6). The materiality of the statements and the actual knowledge of the victims of the alleged fraud are issues whose resolution requires more evidence. Nevertheless, these allegations do not withstand a motion to dismiss under Fed. R. Civ. P. 9(b).

Rule 9(b) requires that "all averments of fraud ... shall be stated with particularity." To satisfy Rule 9(b), the complaint must specify:

(1) precisely what statements were made in

> what documents or oral representations or what omissions were made, and
> (2) the time and place of each such statement and the person responsible for making (or, in the case of omissions, not making the same),
> (3) the content of such statements and the manner in which they misled the [victim], and
> (4) what the defendants "obtained as a consequence of the fraud."

Conan Properties, Inc. v Mattel, Inc., 619 F. Supp. 1167, 1172 (S.D.N.Y. 1985) (quoting *Todd v. Oppenheimer & Co.*, 78 F.R.D. 415, 420-421 (S.D.N.Y. 1978)). Plaintiffs' complaint is detailed enough to satisfy the above requirements.[3]

In addition, although Rule 9(b) provides that intent and "other condition of mind" may be averred generally, plaintiffs must "provide some factual basis for conclusory allegations as to state of mind." *Soper v. Simmons*

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[3] The memoranda of law raise the question of whether the latter requirement is narrowly what was obtained as a consequence of the fraud or, more broadly, "what was obtained or given up as a consequence of the fraud." 2A J. Moore & J. Lucas, 9-20 through 9-24 (1984). The complaint clearly sets out the victims' alleged loss from a lower sales price.

Whether the plaintiffs must allege that defendants, rather than third parties, benefitted from the fraudulent scheme is a question of substantive law rather than a pleading rule. While trustee's commissions and attorney's fees, funds which presumably would have been received by defendants regardless of any fraud on their part, would hardly seem to be "income derived, directly or indirectly, from a pattern of racketeering activity" within the meaning of §1962(a), it is unnecessary to reach that question here. It will be assumed that the allegations of the victims' losses satisfies Rule 9(b).

Int'l. Ltd., No. 84 Civ. 0070, slip op. at 7 (S.D.N.Y. Feb. 27, 1986) (Sand, J.); *see e.g., Ross v. A. H. Robins Co.*, 607 F. 2d 545, 558 (2d Cir. 1979), *cert. denied*, 446 U.S. 946 (1980); *Crystal v. Foy*, 562 F. Supp. 422, 426 (S.D.N.Y. 1983) (dismissing complaint on grounds that allegations "provide no basis from which a fair and reasonable inference may be drawn of manipulative and fraudulent conduct") (Weinfeld, J.); *River Plate Reinsurance Co. v. Jay-Mar Group, Ltd.*, 588 F. Supp. 23, 26 (S.D.N.Y. 1984). While plaintiffs have laid out in detail the alleged misrepresentations and nondisclosures, they have not stated facts that support their claim that defendants' acts, in essence alleged breaches of fiduciary duty, were done with the requisite scienter. Plaintiffs' recital of the allegations of the Amended Complaint, *see* Memorandum of Plaintiffs in Opposition to Motion to Dismiss, at 41-45, emphasizes the lack of factual basis for allegations as to state of mind. The facts alleged point to a breach of fiduciary duty rather than fraud. Defendants' only gain was attorneys' and trustees' fees, sums not alleged to be higher than the amounts the defendants would have received absent the alleged fraud. The complaint alleges no facts to provide a reason why the defendants intended to defraud their victims at no benefit to themselves.

"Pattern of Racketeering Activity"

An alternative basis for dismissal of the complaint is plaintiffs' failure to adequately plead a "pattern of racketeering activity." RICO requires not only that a defendant engage in "racketeering activity," but that its commission of racketeering offenses comprise a "pattern." 18 U.S.C. §1962(a)-(d). The statute defines "pattern" as requiring at least two of the enumerated predicate acts within a ten-year period. 18 U.S.C. §1961(5).

In *Sedima, S.P.R.L. v. Imrex Co.*, 105 S. Ct. 3275 (1985),

the Supreme Court indicated that two acts are necessary but not sufficient to create a "pattern." *Id.* at 3285 n. 14. Noting that "in common parlance two of anything do not generally form a 'pattern,'" the Court construed the term "pattern" to require a relationship and continuity between predicate acts. *Id.* While the relationship between the alleged fraudulent acts is apparent and defendants so concede, the "continuity" requirement is sharply in issue here.

This court and others have consistently held that a defendant who commits various criminal acts in the course of one fraudulent scheme has not committed a "pattern of racketeering" under *Sedima.* "Surely the continuity inherent in the term presumes repeated criminal activity, not merely repeated acts to carry out the same criminal activity." *Northern Trust Bank/O'Hare, N.A. v. Inryco, Inc.*, 615 F. Supp. 828, 831 (N.D. Ill. 1985) A pattern "must include racketeering acts sufficiently unconnected in time of substance to warrant consideration as separate criminal episodes." *Allington v. Carpenter*, 619 F. Supp. 474 (C.D. Cal. 1985). A summary of this court's treatment of the "pattern" element appears in *Richter v. Sudman*, No. 85 Civ. 2773 (S.D.N.Y. Apr. 30, 1986) (Goettel, J.). In *Richter*, the defendants allegedly fraudulently induced the plaintiffs to raise capital over a period of months to be invested in defendants' "Tartufo" company, and plaintiffs deposited the funds in an escrow account to be withdrawn only after certain conditions were satisfied. Without the knowledge or consent of plaintiffs, defendants withdrew and spent plaintiffs' funds. Plaintiffs brought an action under RICO, alleging four separate fraudulent schemes by defendants: the first inducing plaintiffs to raise capital, the second inducing plaintiffs to deposit the funds in escrow, the third concealing the withdrawal of the money and the fourth involving the expenditure of the money. In dismissing the action for

failure to plead a "pattern," the *Richter* court articulated several narrow litmus tests for determining whether a "pattern" was alleged, none of which plaintiffs have satisfied here.

First, the court noted that the plaintiffs' articulation of four allegedly separate fraudulent schemes was not enough because "[a]lthough the specific actions underlying each alleged fraud varies, each served a common end, raising money for Tartufo without apparent regard for the interests of potential investors." *See also Crummere v. Brown*, No. 85 Civ. 1376, slip op. at 9 (S.D.N.Y. Apr. 3, 1986) ("[t]he mere fact that [defendants'] alleged fraudulent obtaining of the funds occurred in steps rather than in the securing of a single check comprising the entire amount cannot convert this lone fraudulent scheme into different criminal episodes"); *Superior Oil Co. v. Fulmer*, Nos. 84-2511, 84-2561 (8th Cir. Mar. 5, 1986) (Although the defendants committed numerous predicate acts over a period of years in fraudulently converting gas from plaintiff's pipeline, no "pattern" was established because defendants' actions "comprised one continuing scheme"); *Soper v. Simmons Int'l. Ltd.*, No. 84 Civ. 0070, slip op. at 15-16 (S.D.N.Y. Feb. 27, 1986) (in suit alleging a fraudulent scheme to deprive plaintiffs of commissions in connection with their arrangement of a joint venture agreement between defendants, the court held that defendants' "ministerial acts performed in the execution of a single [allegedly] fraudulent scheme" did not establish a pattern of racketeering activity); *Modern Settings, Inc. v. Prudential-Bache Securities, Inc.*, No. 83 Civ. 6291 (S.D.N.Y. Jan. 8, 1986) (despite the fact that defendants' alleged fraudulent liquidation of plaintiff's securities holdings involved "multiple sales," "each is but a part of a single transaction" and "[t]here is no pattern of racketeering activity in the liquidation alone"); *Professional Assets Management, Inc. v. Penn Square Bank, N.A.*, 616 F. Supp.

1418 (W.D. Okla. 1985) (although many actions went into the preparation and issuance of an allegedly fraudulent audit report, it was a "single, unified transaction" and did not constitute a "pattern"); *Morgan v. Bank of Waukegan*, 615 F. Supp. 836, 838 (N.D. Ill. 1985) (allegations that sale of a 20% interest in a "venture" was part of a plot to deprive plaintiffs of their investment and other property pleaded only a "single plot, though spread over several years from its hatching in 1978 to its fruition in 1982" and was insufficient to constitute a pattern).

Similarly, in the instant action, plaintiffs cannot sidestep the "pattern" requirement by alleging the existence of "two completely different overlapping schemes, the first to defraud the holders of non-assenting bonds (Phase II) and the second to defraud Mexico (Phase III)." The remaining claims of fraud, *see supra*, all involve selling the U.S. collateral for a fraudulently low price—a single transaction.

Moreover, the *Richter* court held that a "pattern" was not established because "there [is no] evidence that this particular scheme is on-going or continuous. Once the defendants dispose of the investors funds, the fraudulent scheme comes to an end." *Richter v. Sudman, supra; accord Frankart Distributors, Inc. v. RMR Advertising, Inc.*, 632 F. Supp. 1198, 1201 (S.D.N.Y. 1986) ("There is a distinct and easily defined beginning and end to the transaction at issue here, and all of the alleged predicate offenses ... are merely part of this single transaction."); *Furman v. Cirrito*, No. 82 Civ. 4428 (S.D.N.Y. Mar. 12, 1986) ("There is no allegation ... that this scheme was ongoing. To the contrary, it was time-limited; when the sale was completed, the scheme came to an end."); *Kredietbank, N.V. v. Joyce Morris, Inc.*, No. 84-1903 (D.N.J. Oct. 11, 1985) ("A single matter under litigation is necessarily finite and circumscribed rather than open-ended and potentially

on-going ... [T]he end of the litigation will spell the limit of the enterprises' fraudulent scheme."). Similarly, in this case, plaintiffs have not pleaded a "pattern" because defendants' alleged fraudulent conduct is not on-going or open-ended—it allegedly began with MHT's intentional misreading of the Prior Lien Bond indenture to empower Mexico to order a sale of the U.S. collateral and, most significantly, ended with the sale of the collateral and distribution of the proceeds of the sale.

Furthermore, this court in *Richter* and other cases, also has required a showing that the defendant has a history of involvement in conduct similar to that alleged in the complaint. *Richter v. Sudman, supra* ("The plaintiffs have not alleged that the defendants have engaged in similar schemes to defraud other investors ... "); *Furman v. Cirrito*, No. 82 Civ. 4428 (S.D.N.Y. Mar. 12, 1986) ("There is no allegation that defendants were involved in other such episodes ... "); *Kredietbank N.V. v. Joyce Morris, Inc.*, No. 84-1903 (D.N.J. Oct. 11, 1985) ("the fact that an enterprise makes it a practice to submit false affidavits in lawsuits in general [rather than in a single lawsuit] ... might well indicate a pattern of unlawful activity"); *Superior Oil Co. v. Fulmer*, Nos. 84-2511, 84-2561 (8th Cir. March 5, 1986) ("There was no proof that [defendants] ha[ve] ever done these actions in the past ... [or] were engaged in other criminal activities elsewhere."); *Fleet Management Systems, Inc. v. Archer-Daniels-Midland Co.*, 627 F. Supp. 550 (C.D. Ill. 1986) (allegations of mail and wire fraud violations in furtherance of a scheme to misappropriate plaintiff's computerized system for routing trucks failed to plead a "pattern" because this "isolated criminal episode" presented no "threat of continuing criminal activity").

Plaintiffs have not met the standards articulated by this court for pleading a "pattern" of racketeering

activity. Accordingly, the Amended Complaint is dismissed.

Since the Amended Complaint sets forth colorable claims under RICO, *see Eastway Constr. Corp. v. City of New York*, 762 F. 2d 243, 253 (2d Cir. 1985), defendants' motion for sanctions under Fed. R. Civ. P. 11 and 28 U.S.C. §1927 is denied.

IT IS SO ORDERED.

Dated: New York, N.Y.
September 30, 1986

ROBERT W. SWEET
U.S.D.J.

APPENDIX B

ORDER OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK BY THE HON. ROBERT W. SWEET, U.S.D.J. FILED OCTOBER 15, 1986

HUBERT PARK BECK, DOROTHY FAHS BECK, ROBERT J. BECK and OTTO WEINMANN,

Plaintiffs,

-against-

MANUFACTURERS HANOVER TRUST COMPANY, *et al.*,

Defendants.

U.S. DISTRICT COURT
S.D. OF N.Y.
Filed Oct. 15, 1986

85 Civ. 9361 (RWS)
ORDER

SWEET, J.D.

Pursuant to the opinion of this court filed October 1, 1986, the above action is dismissed with prejudice and without costs to either party.

IT IS SO ORDERED.

DATED: New York, N.Y.
October 8, 1985

ROBERT W. SWEET
U.S.D.J.

APPENDIX C

OPINION AND ORDER ON REARGUMENT BY THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK BY THE HON. ROBERT W. SWEET, U.S.D.J.

HUBERT PARK BECK, DOROTHY FAHS BECK, ROBERT J. BECK and OTTO WEINMANN,

Plaintiffs,

-against-

MANUFACTURERS HANOVER TRUST COMPANY; MILBANK, TWEED, HADLEY & McCLOY; KELLEY DRYE & WARREN; DONALD B. HERTERICH; ISAAC SHAPIRO and EDWARD ROBERTS III,

Defendants.

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85 Civ. 9361 (RWS)

OPINION

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SWEET, D.J.

Plaintiffs have moved for reargument of defendants' motion to dismiss the Amended Complaint, which was granted by this court's opinion of September 30, 1986. For the reasons stated below, the motion for reargument is granted, and the opinion of September 30, 1986 is affirmed.

In the September 30 opinion, this court dismissed plaintiffs' allegations under the Racketeer Influenced and Corrupt Organizations Act ("RICO") for failure to adequately plead scienter. Plaintiffs now argue that scienter is irrelevant to the predicate acts of mail and wire fraud where the defendant is a fiduciary.

Plaintiffs assert that this court in its September 30 opinion, "recognized that the requirement of a specific intent to defraud is abrogated where the defendant is a fiduciary (*Id.* at 9)." Plaintiffs then cite *United States v. Siegel*, 717 F. 2d 9 (2d Cir. 1983), *United States v. Weiss*, 752 F. 2d 777 (2d Cir.), *cert. denied*, 106 S. Ct. 308 (1985) and *United States v. Newman*, 664 F. 2d 12 (2d Cir. 1981) for the proposition that "the only condition of mind required for the conviction of a fiduciary who has breached his duty is his knowing use of the mails to further the fraudulent scheme."

This court did not make the statement attributed to it by plaintiffs, and none of the cases support plaintiffs' contention that there is no scienter requirement when a fiduciary is accused of fraud. The presence of scienter was not at issue in those cases, because the defendants' alleged intent to defraud was clear. In *United States v. Siegel, supra,* 717 F. 2d at 15, the court held that the defendants took proceeds from unrecorded cash sales and intentionally used the money for their own enrichment. The defendants in *United States v. Newman, supra,* 664 F. 2d at 19, were charged with falsely and fraudulently asserting that they maintained interests in securities trading accounts. The court stated that the fraudulent scheme's "object was to filch from the employer its valuable property by dishonest, devious, reprehensible means." *Id.* (quoting *Abbott v. United States,* 239 F. 2d 310, 324 (5th Cir. 1956).

In *United States v. Weiss, supra,* 752 F. 2d at 785, the court found that the defendant, among other things, "formulated an elaborate plan, involving phony cash-generating transactions," "created fake feasibility studies and bogus tasks for real estate 'consultants'" and "issued checks for nonperformed legal services." Clearly, the fiduciary defendants in each of the cases cited by plaintiffs acted with scienter.

All three cases cited by plaintiffs to support the proposition that "specific intent to defraud is abrogated where the defendant is a fiduciary" rely on one Second Circuit case, *United States v. Von Barta,* 635 F. 2d 999 (2d Cir. 1980), *cert. denied,* 450 U.S. 998 (1981). *Von Barta* clearly states that:

> to make out a mail fraud violation, the Government must show specific intent to defraud. This specific intent requirement is

> sometimes used to distinguish actual and constructive fraud. Actual frauds are intentional frauds. Constructive frauds involve breaches of fiduciary or equitable duties where an intent to deceive is lacking. Only actual frauds are in the purview of the mail fraud statute.

635 F. 2d at 1005 n. 14. Plainly, a fiduciary's specific intent to commit fraud is an element of violations under the mail fraud statute; the term "scheme to defraud" under the mail and wire fraud statutes "connotes some degree of planning by the perpetrators making it essential that the evidence show the defendants entertained an intent to defraud." *Soper v. Simmons Int'l, Ltd.*, 632 F. Supp. 244, 250 (S.D.N.Y. 1986).

Plaintiffs next argue that this court's decision on the "pattern" issue has been implicitly overruled by the Second Circuit's opinion in *United States v. Teitler*, Nos. 85-1364, 85-1382, 85-1404 (2d Cir. Sept. 25, 1986) and expressly overruled by the Seventh Circuit's decision in *Morgan v. Bank of Waukegan*, No. 85-2675 (7th Cir. Oct. 23, 1986).[1]

The plaintiffs do not explain the grounds on which *Teitler* overrules this court's decision, and nothing in the *Teitler* decision appears to provide any support for plaintiffs' motion. That opinion does not address the conclusion arrived at in this case, that criminal acts in the course of one fraudulent scheme or single transaction do not constitute a "pattern of racketeering." The charge given

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[1] The Seventh Circuit's decision in *Morgan* was brought to this court's attention by letter dated November 21, 1986.

in the lower court and approved in *Teitler* by the Second Circuit merely required the government to prove that the predicate acts "constitute part of a larger pattern of activity," *Teitler, supra*, slip op. at 6033, a conclusion not inconsistent with this court's opinion.

While the Seventh Circuit expressly addresses the proposition that predicate acts under RICO must occur as part of separate schemes in order to constitute a pattern of racketeering activity, *see Morgan v. Bank of Waukegan*, No. 85-2675 (7th Cir. Oct. 23, 1986), and rejects this court's view, that decision is not controlling here. Although this court cited *Northern Trust Bank/O'Hare v. Inryco, Inc.*, 615 F. Supp. 828 (N.D. Ill. 1985), a decision presumably overruled by *Morgan*, it relied as well on precedent in this Circuit for the proposition that more than a single fraudulent scheme must be alleged. *See, e.g., Soper v. Simmons Int'l. Ltd.*, No. 84 Civ. 0070, slip op. at 15-16 (S.D.N.Y. Jan. 8, 1986). This court declines to follow the Seventh Circuit's opinion in *Morgan*.

Therefore, the dismissal of the complaint is affirmed.

IT IS SO ORDERED.

DATED: New York, N.Y.
December 5, 1986

ROBERT W. SWEET
U.S.D.J.

APPENDIX D

OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT
No. 922 — August Term 1986

Argued: March 11, 1987 Decided: June 1, 1987
Docket No. 86-7927

HUBERT PARK BECK, DOROTHY FAHS BECK, ROBERT J. BECK and OTTO WEINMANN,

Plaintiffs-Appellants,

v.

MANUFACTURERS HANOVER TRUST COMPANY; MILBANK, TWEED, HADLEY & McCLOY; KELLEY DRYE & WARREN; DONALD B. HERTERICH; ISAAC SHAPIRO; and EDWARD ROBERTS, III,

Defendants-Appellees.

Before: MESKILL and NEWMAN, Circuit Judges and METZNER, District Judge.*

Appeal from a judgment of the District Court for the Southern District of New York (Robert W. Sweet, Judge)

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* The Honorable Charles M. Metzner of the United States District Court for the Southern District of New York, sitting by designation.

dismissing plaintiffs' action alleging violations by the defendants of the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §§1961-68 (1982 & Supp. III 1985). 645 F. Supp. 675 (S.D.N.Y. 1986); 650 F. Supp. 48 (S.D.N.Y. 1986).

Affirmed.

Stuart Hecker, New York, N.Y. for plaintiffs-appellants.

Adlai S. Hardin, Jr., New York, N.Y. (Milbank, Tweed, Hadley & McCloy, Kelley, Drye & Warren, New York, N.Y., on the brief), for defendants-appellees.

JON O. NEWMAN, Circuit Judge:

This appeal raises the recurring question whether a complaint adequately pled a violation of the Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. §§1961-68 (1982 & Supp. III 1985). Plaintiffs appeal from a judgment of the District Court for the Southern District of New York (Robert W. Sweet, Judge) dismissing their complaint alleging civil RICO violations by Manufacturers Hanover Trust Co. and other defendants. The complaint was dismissed for failure to plead adequately the scienter element of the alleged predicate acts of mail fraud, 18 U.S.C. §1341 (1982), and wire fraud, 18 U.S.C. §1343 (1982), and, in the alternative, for failure to plead the "pattern" requirement of RICO, 18 U.S.C. §§1961(5), 1962(c). 645 F. Supp. 675 (S.D.N.Y. 1986); 650 F. Supp. 48 (S.D.N.Y. 1986). Because we conclude that the amended complaint does not adequately plead the "enterprise" element of RICO, 18 U.S.C. §§1961(4), 1962(c), we affirm the judgment of the District Court.

Background

The circumstances alleged in the amended complaint are complex. In 1902, National Railroad Company of Mexico ("National"), a Utah corporation, issued $23,000,000 principal amount of 4-1/2% Prior Lien Bonds ("Prior Lien Bonds") and $27,289,000 First Consolidated Mortgage Bonds ("Consolidated Mortgage Bonds"). As security for the bonds, National pledged to the trustee certain of its railway properties ("U.S. collateral"). The Prior Lien Bonds represented a first mortgage against the U.S. collateral and certain collateral in Mexico; the Consolidated Mortgage Bonds were subordinated to the Prior Lien Bonds. Article Four, Section Five of the Prior Lien Trust Indenture states that

> the holders of seventy-five (75) per cent. in amount of the prior lien bonds outstanding from time to time, shall have the right to direct and to control the method and place of conducting any and all proceedings for any sale of the premises hereby conveyed, mortgaged or pledged, or for the foreclosure of this indenture ...

Plaintiffs Hubert Park Beck, Dorothy Fahs Beck, Robert J. Beck, and Otto Weinmann hold $1,500 principal amount of Prior Lien Bonds and $153,500 of Consolidated Mortgage Bonds. Manufacturers Hanover Trust Company ("MHT"), defendant, is the successor trustee for both series of bonds. The other defendants are Donald B. Herterich, a senior vice-president of MHT; Kelley Drye & Warren ("Kelley Drye"), counsel to MHT; Edward Roberts, III, a Kelley Drye partner; Milbank, Tweed, Hadley & McCloy ("Milbank"), counsel to Mexico; and Isaac Shapiro, a Milbank partner at the time of the events alleged.

In 1908, Ferrocarriles Nacionales de Mexico ("Ferrocarriles"), a publicly owned Mexican corporation which owns and operates Mexico's railroads, took over National. Through this transaction, Ferrocarriles assumed all of National's liabilities and ownership of National's property, including the U.S. collateral securing the bonds.

National defaulted on interest payments on the bonds in 1914. In 1942, Mexico issued a decree ("the Registration Decree") requiring holders of certain Mexico securities, including the Prior Lien Bonds and Consolidated Mortgage Bonds, to register their bonds to establish non-enemy ownership. In 1951, Mexico promulgated the "Law on the Fate of Enemy Bonds" under which Mexico acquired ownership of all unregistered bonds.

Approximately 96% of the issued and outstanding Prior Lien and Consolidated Mortgage Bonds were registered under the Registration Decree. Plaintiffs' bonds were never registered. Pursuant to a 1946 Debt Readjustment Agreement with the International Committee of Bankers on Mexico and through open market purchases from bondholders, Mexico had by November 1982 acquired all Prior Lien and Consolidated Mortgage Bonds registered under the Registration Decree. Plaintiffs allege that bonds redeemed by Mexico pursuant to the Debt Readjustment Agreement were to have been retired by January 1, 1975.

Between 1942 and 1981, MHT, as indenture trustee, made numerous distributions of accrued and unpaid interest to holders of Prior Lien Bonds. Despite the Law on the Fate of Enemy Bonds, MHT treated the holders of unregistered bonds as legal owners of the bonds entitled to receive distributions. In addition, MHT treated Mexico as the owner of approximately 96% of the bonds it had acquired, notwithstanding plaintiffs' objections that

Mexico was not entitled to receive distributions as a bondholder in view of the Debt Readjustment Agreement.

Mexico, acting pursuant to Article Four, Section Five of the Prior Lien Trust Indenture, instructed MHT to foreclose the Prior Lien Mortgage and sell the U.S. collateral at a public auction on November 2, 1982. Following appraisal of the U.S. collateral, an upset price of $31 million was determined. The public auction and the upset price were published in a notice of sale dated August 10, 1982. At the auction, Mexrail, Inc., the sole bidder, purchased the U.S. collateral for the upset price. The sale was consummated on November 29, 1982. In December 1982, MHT published and mailed to known bondholders a notice stating that it would distribute $1,355 of accrued and unpaid interest from the proceeds of the sale of U.S. collateral on each $1,000 Prior Lien Bond presented.

In March 1983, plaintiffs instituted an action in Supreme Court, New York County, alleging that MHT breached its fiduciary responsibilities in its administration of the indenture trust. *Beck v. Manufacturers Hanover Trust Co.*, No. 12896/83 (*"Beck I"*). Plaintiffs later instituted a second lawsuit in New York alleging that MHT breached its fiduciary responsibilities in the conduct of its defense in *Beck I*. *Beck v. Manufacturers Hanover Trust Co.*, No. 15145/85.

In November 1985, plaintiffs brought a civil RICO action against defendants in the District Court for the Southern District of New York alleging wrongdoing in connection with the interest payments to Mexico between 1942 and 1981, the sale of U.S. collateral, and the disposition of the proceeds of that sale. The amended complaint alleges a three-phase conspiracy. During Phase I,

defendants allegedly defrauded non-assenting bondholders by paying interest to Mexico in violation of the Debt Readjustment Agreement. During Phase II, defendants allegedly defrauded non-assenting bondholders by depriving them of substantially the entire value of the U.S. collateral by selling it at an artificially low price and by treating Mexico as a bondholder entitled to approximately 96% of the proceeds of the sale. During Phase III, defendants allegedly defrauded the Government and people of Mexico by depriving them of their purported share of the proceeds of the sale of the U.S. collateral through the low sale price, the failure to disclose to the Government of Mexico that it was being defrauded by its nationals, and the acceptance by MHT of a fraudulently and legally ineffective assignment of approximately 96% of the Prior Lien Bonds from Mexrail, Inc. in substantial satisfaction of the sale price of the U.S. collateral.

Defendants moved to dismiss the amended complaint pursuant to Fed. R. Civ. P. 12(b)(6) and 9(b) and for failure to adhere to the applicable statute of limitations. Judge Sweet granted defendants' motion to dismiss on the alternative grounds that plaintiffs had not adequately pled "racketeering activity" or a "pattern of racketeering activity" as required by RICO. 645 F. Supp. 675 (S.D.N.Y. 1986). Judge Sweet later heard reargument but adhered to his prior ruling. 650 F. Supp. 48 (S.D.N.Y. 1986).

Discussion

The gravamen of plaintiffs' amended complaint is that defendants violated RICO through their involvement in the allegedly improper treatment of bonds held by Mexico and the sale and disposition of the proceeds of the U.S. collateral. One component of a viable claim for damages under RICO is a proper allegation that defendants committed two or more "predicate" acts, 18 U.S.C.

§1961(1), constituting a "pattern of racketeering activity." 18 U.S.C. §§1961(5), 1962, 1964(c). *See Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 495-96 (1985);*Moss v. Morgan Stanley, Inc.*, 719 F. 2d 5, 17 (2d Cir. 1983), *cert. denied*, 465 U.S. 1025 (1984). Plaintiffs" amended complaint alleged multiple violations of the mail fraud statute, 18 U.S.C. §1341, and the wire fraud statute, 18 U.S.C. §1343, as the predicate acts committed by the defendants. The initial question on this appeal is whether the amended complaint pled the scienter element of these violations with sufficient detail to satisfy Fed. R. Civ. P. 9(b).

1. Adequacy of Pleading Scienter

In general, the mail and wire fraud statutes require, *inter alia*, a showing of intentional fraud. *See United States v. Von Barta*, 635 F. 2d 999, 1005 n. 14 (2d Cir. 1980), *cert. denied*, 450 U.S. 998 (1981); *Soper v. Simmons Int'l, Ltd.*, 632 F. Supp. 244, 250 (S.D.N.Y. 1986). Although Rule 9(b) provides that intent and "other condition of mind" may be averred generally, plaintiffs must nonetheless provide some factual basis for conclusory allegations of intent. *Connecticut National Bank v. Fluour Corp.*, 808 F. 2d 957, 962 (2d Cir. 1987); *Ross v. A.H. Robins Co.*, 607 F. 2d 545, 558 (2d Cir. 1979), *cert. denied*, 446 U.S. 946 (1980); *Soper v. Simmons Int'l, Ltd., supra*, 632 F. Supp. at 249. These factual allegations must give rise to a "strong inference" that the defendants possessed the requisite fraudulent intent. *See Connecticut National Bank v. Fluour Corp., supra*, 808 F. 2d at 962; *Ross v. A.H. Robins Co., supra*, 607 F. 2d at 558.

A common method for establishing a strong inference of scienter is to allege facts showing a motive for committing fraud and a clear opportunity for doing so. *See, e.g., Goldman v. Belden*, 754 F. 2d 1059, 1070 (2d Cir. 1985). Where motive is not apparent, it is still possible to plead scienter by identifying circumstances indicating

conscious behavior by the defendant, *see United States v. Simon*, 425 F. 2d 796, 808-09 (2d Cir. 1969), *cert. denied*, 397 U.S. 1006 (1970); *cf. Gibbons v. Udaras na Gaeltachta*, 549 F. Supp. 1094, 1124 (S.D.N.Y. 1982), though the strength of the circumstantial allegations must be correspondingly greater, *cf. United States v. Simon, supra*, 425 F. 2d at 808-10.

The present case falls into the latter category of cases. Plaintiffs have not alleged any facts indicating motive on the part of defendants. They concede that defendants did not stand to gain financially from the allegedly fraudulent transactions. They base their allegations of scienter solely on the circumstances surrounding the interest payments to Mexico and the sale of the U.S. collateral.

Plaintiffs' amended complaint does not provide an adequate basis for the requisite inference of scienter with respect to Phase I of the alleged conspiracy. Throughout the period 1942 to 1981, MHT consistently adhered to a practice of paying interest to all holders of Prior Lien Bonds, including Mexico. These interest payments to Mexico were disclosed in MHT's notices of distribution. Plaintiffs failed to identify any circumstances related to these interest payments indicating an intent by the defendants to defraud the non-assenting bondholders. At most, plaintiffs have alleged that MHT breached its fiduciary duty by paying interest to Mexico after its bonds were to have been retired.

With respect to Phases II and III of the alleged conspiracy, however, plaintiffs have adequately pled scienter. Plaintiffs alleged two sets of unusual circumstances surrounding the sale of the U.S. collateral that give rise to a strong inference of scienter. The first set involves the manner in which the upset price for the U.S. collateral was determined. Plaintiffs alleged, with supporting documents, that the valuations underlying this determination

were procured by Mexican nationals who eventually purchased the collateral for the upset price. Plaintiffs also alleged facts indicating that the sale of the U.S. collateral was made in violation of the Hart-Scott-Rodino Antitrust Improvement Act of 1976, Pub. L. No. 94-435, 90 Stat. 1383, which requires prenotification of federal authorities regarding specified sales of assets, 15 U.S.C. §18A (1982 & Supp. III 1985). Plaintiffs' asserted reason for this violation was the Mexican nationals' need to consummate the sale prior to the change of Mexican administration on December 1, 1982. Defendants have not offered any alternate explanation for either of these sets of circumstances. These circumstances, read in the context of plaintiffs' other allegations, create, for purposes of testing the validity of a complaint a strong inference that defendants consciously engaged in activities enabling the Mexican nationals to acquire the U.S. collateral at a fraudulently low price.

Consequently, we hold that the District Court erred in ruling that none of plaintiffs' allegations of mail and wire fraud adequately pled scienter. We affirm Judge Sweet's ruling that plaintiffs failed to allege scienter adequately with respect to Phase I but reverse his holding that the allegations of scienter with respect to Phases II and III were inadequate.

2. Adequacy of Pleading "Pattern of Racketeering Activity"

The District Court ruled, as an alternative ground for dismissal, that plaintiffs' amended complaint failed to plead adequately a "pattern of racketeering activity." Sharing a view expressed elsewhere, *e.g.*, *Superior Oil Co. v. Fulmer*, 785 F. 2d 252, 257 (8th Cir. 1986), Judge Sweet interpreted footnote 14 of *Sedima, S.P.R.L. v. Imrex Co.*, *supra*, 473 U.S. at 496, to impose a "multiple episodes"

requirement upon the "pattern" element of RICO. *See* 645 F. Supp. at 683-85; 650 F. Supp. at 50. Applying this standard, Judge Sweet concluded that plaintiffs had failed to allege a RICO pattern.

On the day preceding issuance of Judge Sweet's final decision ordering dismissal, and apparently after his reconsideration, our Circuit decided *United States v. Ianniello*, 808 F. 2d 184 (2d Cir. 1986), which considers the effect of *Sedima*'s footnote 14 on our Circuit's interpretation of the "pattern" element of RICO. Judge Mahoney expressly rejected a multiple episodes requirement, *id.* at 190, 192 n. 15; he did, however, highlight that our Circuit has given effect to the factor of "continuity plus relationship" discussed in *Sedima* through our interpretation of the "enterprise" element of RICO, 18 U.S.C. §§1961(4), 1962(c). *Id.* at 191.

It is clear after *Ianniello* that the District Court erred in interpreting "pattern of racketeering activity" to require multiple episodes. *Ianniello* confirms that two related predicate acts will suffice to establish a pattern under 18 U.S.C. §1961(5). *Id.* at 189-90. Plaintiffs' amended complaint pleads at least two related acts of mail and wire fraud with regard to the sale of the U.S. collateral and therefore satisfies the pleading requirement for "pattern of racketeering activity."

3. Adequacy of Pleading "Enterprise"

Focusing on the solace provided by *Ianniello*, defendants argue that the District Court's judgment should be affirmed on the ground that plaintiffs' amended complaint fails to allege adequately a RICO enterprise. *Ianniello* emphasizes that a plaintiff must prove the existence of a continuing enterprise under 18 U.S.C. §1962(c):

> An enterprise is "a group of persons associated together for a common purpose of engaging in a course of conduct" and "is proved by evidence of an ongoing organization, formal or informal, and by evidence that the various associates function as a continuing unit." *United States v. Turkette*, 452 U.S. 576, 583, 101 S. Ct. 2524, 2528, 69 L. Ed. 2d 246 (1981). This circuit requires that, under section 1962(c), the enterprise be a continuing operation and that the [predicate] acts be related to the common purpose.

Id. at 191 (emphasis added).

Defendants' contention is significantly strengthened by our holding above the plaintiffs have sustained their pleading burden with regard to only those predicate acts associated with the sale of the U.S. collateral. As *Ianniello* recognized, whether one looks for the requisite continuity and relatedness by examining the pattern or the enterprise is really a matter of form, not substance. *Id.* at 191. A consequence of that observation for this case is that with the elimination of Phase I from consideration, the enterprise alleged by plaintiffs had but one straightforward, short-lived goal—the sale of the U.S. collateral at a reduced price. At the conclusion of the sale, the alleged enterprise ceased functioning. *Cf. United States v. Ianniello, supra*, 808 F. 2d at 191-92 (noting that "[t]he common purpose in this case was to skim profits and had no obvious terminating goal or date" (emphasis added)). Such an association is not sufficiently continuing to constitute an "enterprise" under 18 U.S.C. §§1961(4), 1962(c). *Cf. Moss v. Morgan Stanley Inc., supra*, 719 F. 2d at 22; *United States v. Mazzei*, 700 F. 2d 85, 89 (2d Cir.), *cert. denied*, 461 U.S. 945 (1983). For lack of an adequate allegation of a RICO enterprise, the complaint

was vulnerable to dismissal.

The judgment of the District Court is affirmed.

APPENDIX E

ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT FILED ON JUNE 1, 1987

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the 1st day of June one thousand nine hundred and eighty-seven.

Present: HON. THOMAS J. MESKILL,
HON. JON O. NEWMAN,
Circuit Judges,
HON. CHARLES M. METZNER,
District Judge.*

United States Court of Appeals
Second Circuit
Filed
June 1, 1987
Elaine B. Goldsmith, Clerk

U.S. DISTRICT COURT
S.D. OF N.Y.
FILED
JUL. 24, 1987
#87,1368

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* The Honorable Charles M. Metzner of the United States District Court for the Southern District of New York, sitting by designation.

HUBERT PARK BECK, DOROTHY FAHS BECK, ROBERT J. BECK and OTTO WEINMANN,

Plaintiffs-Appellants,

-v.-

MANUFACTURERS HANOVER TRUST COMPANY; MILBANK, TWEED, HADLEY & McCLOY; KELLEY DRYE & WARREN; DONALD B. HERTERICH; ISAAC SHAPIRO; and EDWARD ROBERTS, III,

Defendants-Appellees.

No. 86-7927

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the Judgment of said District Court be and it hereby is affirmed in accordance with the opinion of this court with costs to be taxed against the appellants.

A TRUE COPY
ELAINE B. GOLDSMITH

s/

Elaine B. Goldsmith,
Clerk

s/
By: Edward J. Guardaro,
Deputy Clerk

APPENDIX F

ORDER OF THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT DENYING PETITION FOR REHEARING, ENTERED JULY 14, 1987

UNITED STATE COURT OF APPEALS
FOR THE
SECOND CIRCUIT

At a stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse, in the City of New York, on the 14th day of July one thousand nine hundred and eighty-seven.

HUBERT PARK BECK, DOROTHY FAHS BECK, ROBERT J. BECK and OTTO WEINMANN,

Plaintiffs-Appellants,

-v.-

MANUFACTURERS HANOVER TRUST COMPANY; MILBANK, TWEED, HADLEY & McCLOY; KELLEY DRYE & WARREN; DONALD B. HERTERICH; ISAAC SHAPIRO; and EDWARD ROBERTS, III,

Defendants-Appellees.

A petition for rehearing containing a suggestion that the action be reheard in banc having been filed herein by plaintiffs-appellants Hubert Park Beck, et al.,

Upon consideration by the panel that heard the

appeal it is

ORDERED that said petition for rehearing is DENIED.

It is further noted that the suggestion for rehearing in banc has been transmitted to the judges of the court in regular active service and to any other judge that heard the appeal and that no such judge has requested that a vote be taken thereon.

s/
Elaine B. Goldsmith,
Clerk

APPENDIX G

TEXT OF 18 U.S.C. §§ 1961 AND 1962

§1961. Definitions

As used in this chapter [18 USCS §§ 1961 et seq.]—

(1) "racketeering activity" means (A) any act or threat involving murder, kidnapping, gambling, arson, robbery, bribery, extortion, or dealing in narcotic or other dangerous drugs, which is chargeable under State law and punishable by imprisonment for more than one year; (B) any act which is indictable under any of the following provisions of title 18, United States Code: Section 201 (relating to bribery), section 224 (relating to sports bribery), sections 471, 472, and 473 (relating to counterfeiting), section 659 (relating to theft from interstate shipment) if the act indictable under section 659 is felonious, section 664 (relating to embezzlement from pension and welfare funds), sections 891-894 (relating to extortionate credit transactions), section 1084 (relating to the transmission of gambling information), section 1341 (relating to mail fraud), section 1343 (relating to wire fraud), section 1503 (relating to obstruction of justice), section 1510 (relating to obstruction of criminal investigations), section 1511 (relating to the obstruction of State or local law enforcement), section 1951 (relating to interference with commerce, robbery, or extortion), section 1952 (relating to racketeering), section 1953 (relating to interstate transportation of wagering paraphernalia), section 1954 (relating to unlawful welfare fund payments), section 1955 (relating to the prohibition of illegal gambling businesses), sections 2314 and 2315 (relating to interstate transportation of stolen property), sections 2341-2346 (relating to trafficking

in contraband cigarettes), sections 2421-24 (relating to white slave traffic), (C) any act which is indictable under title 29, United States Code, section 186 [29 USCS §186] (dealing with restrictions on payments and loans to labor organizations) or section 501(c) [29 USCS §501(c)] (relating to embezzlement from union funds), or (D) any offense involving bankruptcy fraud, fraud in the sale of securities, or the felonious manufacture, importation, receiving, concealment, buying, selling, or otherwise dealing in narcotic or other dangerous drugs punishable under any law of the United States;

(2) "State" means any State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, any political subdivision, or any department, agency, or instrumentality thereof;

(3) "person" includes any individual or entity capable of holding a legal or beneficial interest in property;

(4) "enterprise" includes any individual, partnership, corporation, association, or other legal entity, and any union or group of individuals associated in fact although not a legal entity;

(5) "pattern of racketeering activity" requires at least two acts of racketeering activity, one of which occurred after the effective date of this chapter [enacted Oct. 15, 1970] and the last of which occurred within ten years (excluding any period of imprisonment) after the commission of a prior act of racketeering activity;

(6) "unlawful debt" means a debt (A) incurred or contracted in gambling activity which was in violation of the law of the United States, a political subdivision thereof, or which is unenforceable under State or Federal law in whole or in part as to principal or interest because of the laws relating to usury, and (B) which was incurred in connection with the business of gambling in violation of the law of the United States,

a State or political subdivision thereof, or the business of lending money or a thing of value at a rate usurious under State or Federal law, where the usurious rate is at least twice the enforceable rate;

(7) "racketeering investigator" means any attorney or investigator so designated by the Attorney General and charged with the duty of enforcing or carrying into effect this chapter [18 USCS §§ 1961 et seq.];

(8) "racketeering investigation" means any inquiry conducted by any racketeering investigator for the purpose of ascertaining whether any person has been involved in any violation of this chapter [18 USCS §§ 1961 et seq.] or of any final order, judgment, or decree of any court of the United States, duly entered in any case or proceeding arising under this chapter [18 USCS §§ 1961 et seq.];

(9) "documentary material" includes any book, paper, document, record, recording, or other material; and

(10) "Attorney General" includes the Attorney General of the United States, the Deputy Attorney General of the United States, any Assistant Attorney General of the United States, or any employee of the Department of Justice or any employee of any department or agency of the United States so designated by the Attorney General to carry out the powers conferred on the Attorney General by this chapter [18 USCS §§ 1961 et seq.]. Any department or agency so designated may use in investigations authorized by this chapter [18 USCS §§ 1961 et seq.] either the investigative provisions of this chapter [18 USCS §§ 1961 et seq.] or the investigative power of such department or agency otherwise conferred by law.

§1962. Prohibited activities

(a) It shall be unlawful for any person who has received

any income derived, directly or indirectly, from a pattern of racketeering activity or through collection of an unlawful debt in which such person has participated as a principal within the meaning of section 2, title 18, United States Code [18 USCS §2], to use or invest, directly or indirectly, any part of such income, or the proceeds of such income, in acquisition of any interest in, or the establishment or operation of, any enterprise which is engaged in, or the activities of which affect, interstate or foreign commerce. A purchase of securities in the open market for purposes of investment, and without the intention of controlling or participating in the control of the issuer, or of assisting another to do so, shall not be unlawful under this subsection if the securities of the issuer held by the purchaser, the members of his immediate family, and his or their accomplices in any pattern of racketeering activity or the collection of an unlawful debt after such purchase do not amount in the aggregate to one percent of the outstanding securities of any one class, and do not confer, either in law or in fact, the power to elect one or more directors of the issuer.

(b) It shall be unlawful for any person through a pattern of racketeering activity or through collection of unlawful debt to acquire or maintain, directly or indirectly, any interest in or control of any enterprise which is engaged in, or the activities of which affect, interstate or foreign commerce.

(c) It shall be unlawful for any person employed by or associated with any enterprise engaged in, or the activities of which affect, interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity or collection of unlawful debt.

(d) It shall be unlawful for any person to conspire to

violate any of the provisions of subsections (a), (b), or (c) of this section.

APPENDIX H

OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT IN *FURMAN V. CIRRITO, NO. 86-7283*,SLIP OP. (2D CIR. SEPTEMBER 1, 1987)

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 18—August Term, 1986
(Argued October 20, 1986 Decided September 1, 1987)
Docket No. 86-7283

AARON J. FURMAN, MARTIN J. JOEL, JR., ALVIN KATZ, FRANCIS P. MAGLIO, HARVEY SHEID, EVERARD M.C. STAMM and ROBERT C. STAMM,
Plaintiffs,

MARTIN J. JOEL, JR., HARVEY SHEID, EVERARD M.C. STAMM and ROBERT C. STAMM,
Plaintiffs-Appellants,

-v.-

JOHN CIRRITO, HAROLD S. COLEMAN, JOHN A. MILLER, FRANCIS G. REA, PETER M. TOCZEK and A.J. YORKE,
Defendants-Appellees.

Before:
VAN GRAAFEILAND, NEWMAN and PRATT,
Circuit Judges.

Appeal from an order and judgment of the United States District Court for the Southern District of New York (Cooper, J.), dismissing a complaint for failure to allege a "pattern of racketeering activity" under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §§1961-68, and for a resulting lack of subject matter jurisdiction over its pendent state law claims. Affirmed. Judge Pratt dissents in a separate opinion.

SEYMOUR SHAINSWIT, New York, N.Y. (Cooper Cohen Singer Ecker & Shainswit and Steven E. Livitsky, N.Y., N.Y., of Counsel), *for Plaintiffs-Appellants.*

MAX GITTER, New York, N.Y. (Paul, Weiss, Rifkind, Wharton & Garrison and Dorothy E. Roberts, N.Y., N.Y., of Counsel), *for Defendants-Appellees.*

VAN GRAAFEILAND, *Circuit Judge*

This is an appeal from an order of the United States District Court for the Southern District of New York (Cooper, J.) granting appellees' motion under Fed. R. Civ. P. 12(b)(1) and (6) to dismiss appellants' complaint, and from the judgment entered pursuant thereto. For the reasons that follow, we affirm.

Appellants' complaint states three causes of action, two that are state law claims of partnership fraud and breach of fiduciary duty and a third grounded on the Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. §§1961-68. It twice has been dismissed by the district court. The first dismissal was based on appellants' failure to allege a separate, distinct racketeering enterprise injury. 578 F. Supp. 1535 (S.D.N.Y. 1984). This Court's affirmance of that decision, 741 F. 2d 524, was

vacated by the Supreme Court, 105 S. Ct. 3550 (1985), on the basis of its holdings in *Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479 (1985), and *American Nat'l Bank & Trust Co. v. Haroco, Inc.*, 473 U.S. 606 (1985) (per curiam). Following remand to the district court, appellees moved to dismiss for failure to allege a "pattern of racketeering activity", 18 U.S.C. §1962(c), or, in the alternative, to compel arbitration pursuant to the Federal Arbitration Act, 9 U.S.C. §§1-14. Relying on *Sedima, supra*, 473 U.S. at 496 n. 14; *id.* at 527-28 (Powell, J., dissenting), and cases that followed, the district court held that racketeering activity must be continuous and related in order to constitute a pattern and must be ongoing or occur in more than one criminal episode. Although the district court felt that appellees' alleged acts were related, it concluded that the complaint failed to allege any continuity of activity, and dismissed the RICO cause of action. The district court held that it then lacked subject matter jurisdiction over appellants' state law claims, and refused to address appellees' motion to arbitrate.

Because the issue on the first appeal was whether a RICO complaint must allege a racketeering injury separate and apart from that which resulted from "the predicate acts of using mail and wire facilities in violation of 18 U.S.C. §§1341 and 1343" (741 F. 2d at 526), precise factual allegations were treated in summary fashion only and played no determinative role in our decision. Disposition of the present appeal requires that we take cognizance of certain conceded and undisputed facts and recent substantial changes in the law of mail fraud. Although appellees' motion was made under Rule 12(b)(1) and (6), the record before us consists of more than just the complaint. Specifically, it includes the partnership agreement, which spells out the rights and obligations of the parties, the contract for the sale of the partnership assets, whose terms appellants claim were unfair, and affidavits

of counsel for both sides. The district court might have treated the motion as one for summary judgment. *See In re G. & A. Books, Inc.*, 770 F. 2d 288, 295 (2d Cir. 1985), *cert. denied*, 106 S. Ct. 1195 (1986); *Grand Union Co. v. Cord Meyer Development Corp.*, 735 F. 2d 714, 716-17 (2d Cir. 1984). Despite its failure to do so, we nonetheless may refer to the partnership agreement and contract of sale, which are integral parts of appellants' claim and of the record before us. *See Decker v. Massey-Ferguson, Ltd.*, 681 F. 2d 111, 113 (2d Cir. 1982); 5 Wright & Miller, *Federal Practice and Procedure* §§1327, 1357 at 593. Examining the complete picture thus presented, we are unable to discover a sufficient allegation of a "pattern of racketeering activity" conducted in the affairs of an "enterprise", *United States v. Ianniello*, 808 F. 2d 184, 190 (2d Cir. 1986), *cert. denied*, 55 U.S.L.W. 3849 (June 23, 1987); indeed, we have difficulty in discovering a sufficient allegation of racketeering activity at all.

In a complaint based almost entirely on information and belief, appellants accuse appellees of a RICO violation based on the predicate crime of mail fraud. We have, we believe, made it clear that we look with a jaundiced eye upon allegations of fraud based upon information and belief. *Luce v. Edelstein*, 802 F. 2d 49, 54 n. 1 (2d Cir. 1986); *Decker v. Massey-Ferguson, Ltd., supra*, 681 F. 2d at 114. Nevertheless, we have carefully reviewed the complaint, in light of the undisputed documents, in an attempt to understand how appellants are attempting to meet their obligation to allege statutorily required charges of criminal wrongdoing. *See United States v. Angelilli*, 660 F. 2d 23, 34-35 (2d Cir. 1981), *cert. denied*, 445 U.S. 910, 945 (1982). Moreover, unlike the district court in the two hearings before it and this Court on the prior appeal, we have determined the sufficiency of appellants' allegations in accordance with the Supreme Court's "crabbed" construction of the mail fraud statute in

McNally v. United States, No. 86-234, slip op. (June 24, 1987) (Quote is from Justice Stevens' dissenting opinion at 14).

Appellants' RICO allegations, stated succinctly, are as follows:

1. Prior to August 7, 1981, appellants and appellees were general partners in a limited brokerage partnership known as Bruns, Nordeman, Rea & Co. (Bruns).

2. Appellees Coleman and Rea were Bruns Managing Directors, and, by the terms of the written partnership agreement, they "were empowered to sell all or substantially all of the assets of Bruns 'on behalf of all of the partners' on such terms and conditions as they, in their sole discretion, approved."

3. During May and June of 1981, Rea and several members of the Executive Committee negotiated with Bache, Halsey, Stuart, Shields, Inc. (Bache) for the sale to Bache of all or substantially all of Bruns' assets.

4. A preliminary agreement on the terms of the purchase contract was reached on June 30, 1981, and a letter of intent was signed on July 2, 1981.

5. On July 6, 1981, appellants were informed of the deal, which was described as a fait accompli, whose terms could not be altered.

6. At a firm meeting on July 23, 1981, appellants learned for the first time that their signatures would be required on the purchase agreement that was to be executed.

7. On July 27, 1981, all of the appellants executed the

agreement.

8. Appellants were defrauded because they were not told "in a timely manner" that their signatures would be required, that as a result some of the partners were secretly favored over others and appellees did not discharge their "duty of finding the potential purchaser willing to make the largest offer for Bruns' assets."

It is readily apparent that the crucial element in appellants' claim of mail fraud is appellees' alleged failure to promptly inform them that they would have to sign an eventual agreement with Bache. We think that, as an allegation of criminal wrongdoing, this claim borders on the specious.

It is undisputed that, although appellants and appellees were general partners in Bruns, their interests in the firm were far from identical. The six appellees accounted for 75 percent of the general partners' equity, and the remaining 25 percent was allocated among seven partners, four of whom are now appellants. In view of appellees' substantially greater financial interests, it is not surprising that, between them, they comprised the firms' Managing Directors and Executive Committee, which together had the primary responsibility for Bruns' operations.

It is likewise not surprising that, under the terms of the partnership agreement, the Managing Directors had "full power and authority on behalf of all of the partners, at any time, to sell or otherwise transfer all or substantially all of assets and business of the partnership, on such terms and conditions as the Managing Directors, in their sole discretion, [might] approve." The agreement also provided that it would terminate automatically upon the sale of all or substantially all of the partnership assets as an entirety

or the merger or consolidation of the partnership with or into another partnership or corporation. Upon such termination, the Executive Committee was to liquidate the partnership.

The rights and obligations of partners, as between themselves, are fixed by the terms of the partnership agreement. *Levy v. Leavitt*, 257 N.Y. 461, 466 (1931). "If complete, as between the partners, the agreement so made controls." *Lanier v. Bowdoin*, 282 N.Y. 32, 38 (1939). Even terms which permit self-dealing by a partner will be enforced. *Riviera Congress Assocs. v. Yassky*, 25 A.D. 2d 291, 295, *aff'd* 18 N.Y. 2d 540 (1966); *Raymond v. Brimberg*, 99 A.D. 2d 988 (1984) (*mem.*); *Crane and Bromberg on Partnership*, sec. 5 at 43 (1968). Since appellees were acting pursuant to their contractual authority in agreeing to sell the partnership assets, we find no merit whatever in appellants' contention that such sale constituted criminal wrongdoing. *See Fershtman v. Schectman*, 450 F. 2d 1357, 1360 (2d Cir. 1971), *cert. denied*, 405 U.S. 1066 (1972). We find no support for this contention in appellants' allegation upon information and belief that, after appellees had agreed to sell to Bache, they were made aware that a principal of another brokerage firm "was prepared to negotiate the purchase of Bruns at a price that would match or exceed that offered by Bache", and that no appellee made any effort to ascertain whether the "offer" of that firm was superior to that of Bache. Of course, "prepared[ness] to negotiate" is not an "offer" to purchase. In view of the absolute and sole discretion vested in the Managing Directors and the preexisting sales agreement with Bache, this is a frivolous allegation of wrongdoing.

Equally frivolous is appellants' allegation that appellees were guilty of criminal conduct because they failed to promptly inform appellants that they would be

required to sign the written contract between Bruns and Bache. Although Bruns' Managing Directors had the undoubted authority to agree to the sale of the partnership assets, they had no power or authority to deliver their partners to Bache along with the assets. "A contract of employment cannot arise against the will or without the consent of an alleged party thereto." 56 C.J.S. *Master and Servant* §5 at 63; *Morgan v. Wheland Co.*, 66 F. Supp. 439, 440 (E.D. Tenn. 1946). Each Bruns partner and employee had the right to negotiate on his or her own behalf whether, and on what terms, he or she was willing to become associated with Bache.

We note that the partnership agreement required the Managing Directors to give the other partners notice of a proposed sale "not less than thirty (30) days prior to the effective date of the transaction." This was not a meaningless provision. *See Audino v. Lincoln First Bank*, 105 A.D. 2d 1091, 1093 (1984) (*mem.*), *aff'd*, 65 N.Y. 2d 631 (1985). Its obvious purpose was to give the other partners an opportunity to negotiate with Bache and to decide where their best interests lay. The contract between Bruns and Bache contains specific employment or compensation provisions, not only for the six appellees but also for four of the plaintiffs, two of whom are appellants. These provisions for the four plaintiffs would be meaningless if plaintiffs did not personally assent thereto, and, as experienced businessmen, plaintiffs surely knew that. Indeed, the contract provisions for salaries was expressly conditioned upon the recipients' agreement to become employees of Bache.

We note also that several of the partners, including plaintiffs Alvin Katz and Robert C. Stamm, were members of stock exchanges, and under the terms of the partnership agreement they had to determine what disposition was to be made of those memberships. Although

the Bache contract provided for transfer of exchange memberships, this obviously could not be accomplished without the concurrence of individual members.

Even if we accept appellants' implicit contention that they lacked sufficient sophistication to know that they could not be bonded over to Bache without their consent, they make no allegation of anything that prevented them on July 23 from refusing to sign the Bache contract unless they received more favorable personal treatment. Indeed, appellants were in as good, if not better, position to demand more favorable treatment on July 23 than they were a month earlier. At this stage of the proceedings, there certainly was more pressure on the parties to complete the transaction than there was at the outset of negotiations. Moreover, the written contract specifically provided that it could be amended or supplemented if the parties decided that such amendment was "necessary, desirable or expedient ... to facilitate ... the consummation of the transactions contemplated hereby." Appellants' contention that their signatures were coerced by criminal conduct on the part of appellees and that they were "forced to accept employment" on unfavorable terms is too conclusory to support a charge of criminal wrongdoing.

Assuming for the argument that appellants have spelled out some form of criminal fraud on appellees' part, they have not alleged a pattern of racketeering activity conducted in the affairs of an "enterprise". In *Sedima, supra*, 473 U.S. 479, 496 n. 14, the Court held that in order for there to be a pattern of racketeering activity, there must be continuing activity or continuity in the conduct at issue. There, the Court was concerned whether there was sufficient continuity and relatedness in the allegedly wrongful acts that they could be said to constitute a pattern. In *United States v. Weisman*, 624 F. 2d

1118 (2d Cir.), *cert. denied*, 449 U.S. 871 (1980), and again in *United States v. Ianniello, supra*, 808 F. 2d 184, this Court faced the question whether RICO also requires continuity and relatedness in the alleged "enterprise". We answered this question in the affirmative:

> As discussed above, we believe that the inquiry s to relatedness and continuity is best addressed in the context of the concept of "enterprise" expressed in section 1962(c), and to a lesser extent, the ten year requirement of section 1961(5). An enterprise is "a group of persons associated together for a common purpose of engaging in a course of conduct" and "is proved by evidence of an ongoing organization, formal or informal, and by evidence that the various associates function as a continuing unit." *United States v. Turkette*, 452 U.S. 576, 583, 101 S. Ct. 2524, 2528, 69 L. Ed. 2d 246 (1981). This circuit requires that, under section 1962(c), the enterprise be a continuing operation and that the acts be related to the common purpose.

Ianniello, supra, 808 F. 2d at 191; *see also Beck v. Manufacturers Hanover Trust Co.*, 820 F. 2d 46, 51-52 (2d Cir. 1987).

Appellants contend that the Bruns partnership was the "enterprise" required by RICO, but assert in the same breath that the partnership was dissolved by the sale to Bache on August 7, 1981. Moreover, the very acts of which appellants complain were part of the dissolution process. Although, at first blush, the mere existence of a partnership entity would seem to satisfy the requirement of "enterprise", *see* 28 U.S.C. §1961(4), if an inquiry as to the necessary elements of continuity and relatedness is directed at the enterprise, then just being a partnership is not enough. The statute says that "enterprise" includes

partnerships, corporations, etc.; it does not say that all these entities always must be considered to be "enterprises". The existence of an enterprise "is proved by evidence of an *ongoing* organization, formal or informal, and by evidence that the various associates function as a *continuing unit*." *United States v. Turkette, supra*, 452 U.S. at 583 (emphasis supplied). According to appellants' complaint, at the time the allegedly wrongful acts occurred, the Bruns partners were not functioning as a continuing unit in an ongoing organization. Instead, the Bruns Managing Directors were said to be acting solely on their own to prevent the alleged enterprise from being an ongoing, continuing unit. While appellees' conduct need not have been in furtherance of the partnership affairs in order to bring their acts within the ban of RICO, *United States v. LeRoy*, 687 F. 2d 610, 616-17 (2d Cir. 1982), *cert. denied*, 459 U.S. 1174 (1983), since the effect of their acts was to remove Bruns from the very definition of enterprise, the requirement of continuity was not satisfied. We need not determine whether any basis other than RICO exists on which liability might be properly alleged. We simply conclude that a RICO violation has not been adequately pleaded.

The instant case is a paradigmatic example of the unfairness that results when RICO, a statute intended to be an "assault upon organized crime and its economic roots", *Russello v. United States*, 464 U.S. 16, 26 (1983), is used in an attempt to make a "federal case" of a simple falling out between partners. Giving appellants the benefit of every doubt, we conclude they have not succeeded in their attempt. For all of the foregoing reasons, the judgment of the district court is affirmed.

PRATT, *Circuit Judge*, dissenting:

I respectfully dissent. Not only does the majority fail

to assume the facts are as plaintiffs allege them to be, as is required on a motion to dismiss, but it compounds this error by making determinations that are directly contrary to those of the district court and of a unanimous panel of this court on the prior appeal in this case, *Furman v. Cirrito*, 741 F. 2d 524 (2d Cir. 1984) ("*Furman I*"), *vacated and remanded*, 105 S. Ct. 3550 (1985), *on remand*, 779 F. 2d 36 (2d Cir. 1985). Moreover, the majority fails to heed recent circuit precedent that should control this appeal, *United States v. Ianniello*, 808 F. 2d 184 (2d Cir. 1986) *cert. denied*, U.S.L.W. 3853 (June 23, 1987). As the concluding paragraph of the majority's opinion explicitly illustrates, this case now stands next in a long line of judicial attempts to construe narrowly RICO despite congress's express mandate that it should "be liberally construed to effectuate its remedial purpose." Pub. L. 91-452, §904(a), 84 Stat. 947. *See Sedima, S.P.R.L. v. Imrex Co., Inc.*, 473 U.S. 479, ___, 105 S. Ct. 3275, 3286 (1985).

The district court here found only that there was no "pattern" to defendants' racketeering activity. The basis of that conclusion—that *Sedima's* footnote 14 altered the law governing racketeering patterns and that multiple fraudulent episodes are required—was eliminated by *Ianniello*. In affirming the district court, the majority relies on alternative grounds, neither of which was raised or addressed by the parties, and neither of which is supported by the law or the alleged facts. If this case were to be decided on the issues addressed by the district court and argued by the parties, *Ianniello* would require reversal. Since it is, instead, being decided by the majority's conclusions that no racketeering activity has been alleged and that there was no "enterprise", I can only dissent.

A. *The Presence of Alleged Racketeering Activity*

It is required on a motion to dismiss a complaint to

treat as true plaintiff's factual allegations, *Fifth Avenue Peace Parade Comm. v. Gray*, 480 F. 2d 326, 331 (2d Cir. 1973) (on "a motion to dismiss on the pleadings, the allegations of the complaint ... had to be accepted as true"), and to dismiss only if "it appears beyond doubt that plaintiff can prove no set of facts in support of his claim which would entitle him to relief", *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957). The majority, however, finds it difficult to hold to these fundamentals, variously characterizing plaintiffs' allegations as "border[ing] on the specious", "frivolous", and "conclusory". When a proper lens is used to view plaintiffs' complaint, however, a far different picture emerges.

Plaintiffs allege that the sale of the Bruns partnership was accomplished by means of fraudulent concealment of material information (the fact that without plaintiffs' signatures on the sales agreement Bache would not proceed with the sale) in violation of the partnership agreement, which, as the majority concedes, required the managing directors to give notice of a proposed sale to their partners "not less than thirty (30) days prior to the effective date of the transaction". Moreover, plaintiffs allege, in reaching the sales agreement, several of the defendants accepted pay-offs that induced them to agree to the terms negotiated by the managing directors, even though terms more favorable to the partnership were obtainable.

Rather than taking these allegations as true, the court states that it has "carefully reviewed the complaint, in light of the undisputed documents, in an attempt to understand how appellants are attempting to meet their obligation to allege statutorily required charges of criminal wrongdoing." With all due respect, the majority in actuality holds that plaintiffs have failed to justify their charges, rather than to allege the wrongdoing necessary

in a RICO complaint. Nevertheless, the majority is forced to concede that the district court did not view this motion to dismiss as one for summary judgment, and if it had, it would have been required by Fed. R. Civ. P. 12(b) to afford plaintiffs "reasonable opportunity to present all material made pertinent to such a motion by Rule 56." *See In re G. & A. Books, Inc.*, 770 F. 2d 288, 294-95 (2d Cir. 1985) ("[t]he essential inquiry is whether the appellant should reasonably have recognized that the motion might be converted into one for summary judgment or was taken by surprise"). Even if the majority is correct that "the district court might have treated the motion as one for summary judgment", it surely was not error that it did not, and given that it did not, plaintiffs could not have foreseen that this court on appeal suddenly would do so, especially since the defendants made clear in the motion itself that "[f]or our motion to dismiss, we rely on the law" rather than on the facts, and since defendants recognize in their brief on appeal, "Because this is an appeal from dismissal of the complaint, we must accept the allegations of the complaint as true."

But even if we assume that defendants did not violate the notice requirement, the weight the majority places on the managing directors' contractual authority to dispose of the partnership assets "in their sole discretion" is unjustified. The majority says, "Since appellees were acting pursuant to their contractual authority in agreeing to sell the partnership assets, we find no merit whatever in appellants' contention that such sale constituted criminal wrongdoing." The majority points out that under New York law, "[e]ven terms which permit self-dealing by a partner will be enforced"; but the case cited for that proposition, *Riviera Congress Assocs. v. Yassky*, 18 N.Y. 2d 540, 548-49, 277 N.Y.S. 2d 386, 392-93 (1966), holds only that when partners are "fully apprised" that their fellow partners intend to engage in self-dealing, such apprisal

"has the effect of 'exonerating' the [self-dealing partners], ... from adverse inferences that might otherwise be drawn against them simply from the fact that they dealt with themselves." *Id.* at 548 (citation omitted). Nothing in *Yassky*, or in other New York law, permits partners to self-deal and conceal it from their partners.

The majority relies primarily on paragraph 37 of the Bruns partnership agreement, which provides:

> The Managing Directors, by unanimous vote, shall have full power and authority on behalf of all the partners, at any time, to sell or otherwise transfer all or substantially all of [the] assets and business of the partnership, on such terms and conditions as the Managing Directors, in their sole discretion, may approve, provided that notice in writing of such proposed transaction shall be given to all of the partners not less than thirty (30) days prior to the effective date of the transaction.

They point out that under paragraph 37, "Although Bruns' Managing Directors had the undoubted authority to agree to the sale of the partnership assets, they had no power or authority to deliver their partners to Bache along with the assets. ... Each Bruns partner and employee had the right to negotiate on his or her own behalf whether, and on what terms, he or she was willing to become associated with Bache."

In other words, according to the majority, each of the plaintiffs could have negotiated for better terms of his employment or, if not satisfied, could have opted out of the deal and obtained employment elsewhere. Plaintiffs, however, allege, in paragraph 12 of the complaint, that "Bache would not complete the contemplated transaction with Bruns unless and until each and every one of the

general partners of Bruns consented to the transaction and evidenced that consent by signing the Purchase Agreement. However, none of the plaintiffs were informed that Bache was insisting upon their consents."

Assuming, as we must, that this is true, its significance becomes paramount because each one of the plaintiffs could, by refusing to sign up, have done far more than simply "opted out" of joining Bache; they could have instead killed the entire deal and along with it the "sweetheart" contracts that defendants had negotiated for themselves. Defendants thus concealed from plaintiffs the extent of the power that Bache's negotiating position had conferred on each of them.

Nowhere does the majority mention this crucial allegation, nor does it give any reason why paragraph 37 justifies defendants' self-dealing and fraud in concealing from plaintiffs the full picture of the conditions demanded by Bache. Paragraph 37 does not, clearly and unambiguously, authorize defendants to withhold from their partners crucial parts of the deal. At the very least then, if that paragraph is to be construed as permitting this unusual kind of self-dealing and concealment thereof, and as overriding the normal tenet of partnership law that partners owe to one another a fiduciary duty of the "utmost good faith, fairness, [and] loyalty", *Newburger, Loeb & Co., Inc. v. Gross*, 563 F. 2d 1057, 1078 (2d Cir. 1977), *quoting* Crane and Bromberg, Law of Partnership, §68, at 390 (1968); *see also* N.Y. Partnership Law §43(1) (McKinney 1948); *Meinhard v. Salmon*, 249 N.Y. 458, 464, 164 N.E. 545, 546 (1928) (Cardozo, Ch. J.) ("[A] trustee is held to something stricter than the morals of the marketplace. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior."), such a conclusion should be reached only after a finder of fact has so construed it, based on extrinsic evidence

showing additional circumstances not apparent on the face of the agreement.

Until and unless congress changes RICO, mail and wire fraud are as much predicate acts of racketeering activity as murder and blackmail. As judges we have no right effectively to remove from RICO two crimes, mail fraud and wire fraud, that congress has decreed are among the hallmarks of racketeers. The majority seeks to distinguish fraud from other racketeering activity by saying, "We have, we believe, made it clear that we look with a jaundiced eye upon allegations of fraud based on information and belief." The apparent basis for this statement is Fed. R. Civ. P. 9(b): "In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity." *See Luce v. Edelstein*, 802 F. 2d 49, 54 n. 1 (2d Cir. 1986); *Decker v. Massey-Ferguson, Ltd.*, 681 F. 2d 111, 114 (2d Cir. 1982). But rule 9(b) requires only that "a complaint 'must allege with some specificity the acts constituting the fraud'", *id.*, *quoting Rodman v. Grant Foundation*, 608 F. 2d 64, 73 (2d Cir. 1979). Obviously, there is no violation of rule 9(b) here, since plaintiffs have specifically pinpointed the acts and circumstances they allege were fraudulent, and since the district court did not find, nor do defendants allege, any failure to comply with the rule. Instead, the majority extrapolates from the rule a "jaundiced eye" with which to regard allegations of fraud, even when made in compliance with the rule. I see no basis on a rule 12(b)(6) motion for the majority to reject properly pled allegations of fraud, even ones "based upon information and belief", *see Schlick v. Penn-Dixie Corp.*, 507 F. 2d 374, 379 (2d Cir. 1974) ("While all of [the] allegations are stated on information and belief, ... the particularity requirement may be satisfied if, as here, the allegations are accompanied by a statement of the facts upon which the belief is founded.")

The majority does not merely refuse to assume the truth of plaintiffs' well-pled allegations of fraud; what it really does is decide the fraud against them. The proper time and place to decide that issue, however, is at trial, and not on a rule 12(b)(6) motion.

The court says that it has "difficulty in discovering a sufficient allegation of any racketeering activity at all." That may be true, but I feel constrained to point out that the district court in this case—twice—had no trouble whatever finding a sufficient allegation of racketeering activity in plaintiffs' complaint, the first time when it dismissed as "semantical strawmen" defendants' arguments that no pattern of racketeering activity had been alleged, *Furman v. Cirrito*, 578 F. Supp. 1535, 1538 (S.D.N.Y. 1984) ("[C]learly, a 'pattern of racketeering activity' is alleged as 2 or more acts of wire and mail fraud have been alleged."), *aff'd*, 741 F. 2d 524 (2d Cir. 1984), *rev'd and remanded on reconsideration*, 779 F. 2d 36 (2d Cir. 1985), and the second time when it decided, in granting the judgment on appeal here, that plaintiffs had failed to allege a pattern. As Judge Cooper put it, "[W]e do not hesitate to conclude ... that the complaint alleges defendants engaged in racketeering activity since they used the mails and telephone in furtherance of a scheme to defraud. Thus, the only question remaining is whether such activity formed a 'pattern.'" *Furman v. Cirrito*, No. 82 Civ. 4428 (S.D.N.Y. March 12, 1986).

Moreover, the racketeering activity alleged in this complaint was apparent not only to the district court. In *Furman I*, a unanimous panel of this court, reviewing the same complaint, reached the following conclusion on the same allegations:

> [I]t is apparent that plaintiffs have sufficiently alleged those facts required by the statutory

> language .... The alleged pattern of racketeering activity was repeated use of the mails and the wires, in furtherance of defendants' underlying scheme to defraud plaintiffs by concealing from them ... the true conditions for the sale of Bruns.

Furman I, 741 F. 2d at 527. It seems somewhat strange that four federal judges could find sufficient allegations of racketeering activity in the complaint that the court today is able to dismiss, before an answer to the complaint has even been filed, for lack of such allegations.

B. *The Presence of a Racketeering Pattern.*

Since the majority concludes that plaintiffs have failed to allege any racketeering activity, they never come to grips with the only issue raised and briefed by the parties, the content of the RICO requirement that there be a "pattern" of such activity. Since I would conclude that plaintiffs have alleged racketeering activity, I would reach the further issue of the pattern requirement, and would reverse the judgment of the district court on the strength of our recent decision in *Ianniello*.

In a nutshell, this is the situation: In *Furman I*, this court determined that plaintiffs alleged a pattern of racketeering activity. On remand, the district court, believing that the intervening Supreme Court decision in *Sedima* had altered the law on the pattern requirement, decided that no pattern was alleged. After that, however, this court held in *Ianniello* that *Sedima* had *not* altered the law applied in *Furman I*. From this, I can conclude only that *Ianniello* undercuts completely the basis for the district court's decision. Obviously, the majority disagrees. Hence, a more complete discussion of *Sedima* and *Ianniello* is necessary.

The core of the controversy surrounding footnote 14 of *Sedima* is what the Court meant by "continuity" and "relatedness", which it indicated were necessary elements of a "pattern" of racketeering activity. The meaning of footnote 14 has divided the courts that have considered it, *see, e.g., Northern Trust Bank/O'Hare, N.A. v. Inryco, Inc.*, 615 F. Supp. 828, 833 (N.D. Ill. 1985) (*Sedima* created a "whole new ballgame"); *Bank of America National Trust & Savings Assn. v. Touche Ross & Co.*, 782 F. 2d 966, 971 (11th Cir. 1986) (nine predicate acts all part of one scheme satisfy pattern requirement after *Sedima*), but *Ianniello* settles its meaning for our circuit: any necessary "continuity" and "relatedness" are to be found not in "pattern", but in the concept of "enterprise", 18 U.S.C. §1962(c), and in the requirement that the predicate acts take place within a ten-year period, 18 U.S.C. §1961(5). *Ianniello*, 808 F. 2d at 190. *See also United States v. Weisman*, 624 F. 2d 1118, 1122 (2d Cir. 1980).

The majority seeks to distinguish *Ianniello* by finding an absence of an "enterprise" here because the enterprise that might satisfy the pattern requirement—the Bruns partnership itself—was dissolved by the very acts alleged by plaintiffs to have amounted to racketeering. This novel theory, which was never even suggested by defendants or briefed by either side, ignores the simple fact that the dissolution of Bruns occurred as a result of—and after—the fraud took place. The fact that defendants' scheme was successful in putting an end to the enterprise surely should not insulate the schemers from RICO liability. In cases where the purpose of the racketeering activity is to put an end to the enterprise and to profit thereby, there is no reason to believe that congress intended to leave the injury unremedied. It would be anomalous to allow these defendants to escape RICO liability simply because their racketeering activity was successful in achieving its intended result: termination of

the enterprise.

The majority further resists the conclusion that the Bruns partnership was itself the RICO enterprise by implying that defendants' actions were somehow not in the conduct of the enterprise's affairs, a position that, of course, is inherently inconsistent with their earlier conclusion that the partnership agreement authorized defendants to do what they did. The majority says, "[A]t the time allegedly wrongful acts occurred, the Bruns partners were not functioning as a continuing unit in an ongoing organization. Instead, the Bruns Managing Directors were said to be acting solely on their own to prevent the alleged enterprise from being an ongoing, continuing unit." Yet, §1962(c) of RICO provides:

> It shall be unlawful for *any person employed by or associated with any enterprise* engaged in, or the activities of which affect, interstate, or foreign commerce, *to conduct or participate*, directly or indirectly, *in the conduct of such enterprise's affairs through a pattern of racketeering activity* or collection of unlawful debt.

18 U.S.C. §1962(c) (emphasis added). To conclude as the majority apparently does that the sale of the partnership is not "in the conduct of such enterprise's affairs" is surprising, to say the least. That defendants were self-dealing in the conduct of Bruns' affairs does not make their actions any less "in the conduct of [Bruns'] affairs"; what it does do is make their self-dealing, their concealment of it, and their use of the mails in furtherance of it, racketeering.

While the majority here motors past *Ianniello* with hardly a glance in the rear view mirror, another panel's recent opinion in *Beck v. Manufacturers Hanover Trust Co.*,

820 F. 2d 46 (2d Cir. 1987), rides right over it. There the court acknowledged that *Ianniello* rejects any requirement of multiple episodes to allege a "pattern of racketeering activity"; in the next breath, however, it brought the multiple-episode concept back to life by engrafting it onto the "enterprise" requirement. The *Beck* court defined "enterprise" as the racketeering episode allegedly engaged in by the defendants, rather than as what the statute describes: the organizational vehicle by or through which the racketeering activity is undertaken. *See United States v. Turkette*, 452 U.S. 576, 583 (1981) ("The 'enterprise' is not the 'pattern of racketeering activity'; it is an entity separate and apart from the pattern of activity in which it engages."). RICO's plain language makes it improper to conflate "continuing enterprise" and "racketeering activity". By equating "enterprise" with "racketeering activity" and then requiring multiple episodes in order to make the enterprise a "continuing enterprise" *Beck* appears to defer to the authority of *Ianniello*. Realistically, however, *Beck* undercuts *Ianniello* by putting back into the RICO stew the multiple-episode ingredient that *Ianniello* sought to remove.

Such conflict between decisions of this court issued seven months apart, along with the additional confusion that surely will be generated by today's decision, cannot help but make worse what can only be described as a "mess" in the RICO decisions of our district courts. For convenience, I will refer to, the following decisions as either "pre-" or "post-*Ianniello*" and as either in agreement with *Ianniello's* broad reading of pattern or as restricting the term.

> *Andreo v. Friedlander*, 660 F. Supp. 1362, 1369-70 (D. Conn. 1987)
> (Blumenfeld, *J.*) (post-*Ianniello* and applying it);
> *In re Gas Reclamation, Inc. Securities Litigation*, 659 F.

Supp. 493, 514-15 (S.D.N.Y. 1987)
(Sand, *J.*) (post-*Ianniello* and applying it, but reversing earlier, contrary position of Judge Sand);
Siegel v. Tucker, 658 F. Supp. 550, 554-55 (S.D.N.Y. 1987)
(Kram, *J.*) (post-*Ianniello* but not mentioning it and restricting "pattern");
City of New York v. Joseph L. Balkan, Inc., 656 F. Supp. 536, 544-45 (E.D.N.Y. 1987)
(Nickerson, *J.*) (post-*Ianniello* and applying it);
United States v. Weinberg, 656 F. Supp. 1020, 1024-25 (E.D.N.Y. 1987)
(McLaughlin, *J.*) (post-*Ianniello* and applying it);
Continental Health Industries, Inc. v. Franklin & Joseph, Inc., No. 85 Civ. 8756 (S.D.N.Y. March 18, 1987)
(Carter, *J.*) (post-*Ianniello* but nevertheless restricting "pattern" by limiting *Ianniello* to criminal RICO);
Procter & Gamble Co. v. Big Apple Industrial Buildings, Inc., 655 F. Supp. 1179, 1182-84 (S.D.N.Y. 1987)
(Leval, *J.*) (same as *Continental Health Industries*);
Corcoran v. American Plan Corp., No. CV 86-1729 (E.D.N.Y. Feb. 6, 1987)
(Sifton, *J.*) (post-*Ianniello* and applying it);
Shopping Mall Investors, N.V. v. E.G. Frances & Co., Inc., No. 84 Civ. 1469 (S.D.N.Y. January 30, 1987)
(Keenan, *J.*) (post-*Ianniello* but nevertheless restricting "pattern" by limiting *Ianniello* to criminal RICO);
State of New York v. O'Hara, 652 F. Supp. 1049, 1052-53 (W.D.N.Y. 1987)
(Curtin, *Ch. J.*) (post-*Ianniello* and applying it, reversing earlier, contrary position of Judge Curtin);
Cefali v. Buffalo Brass Co., Inc., 653 F. Supp. 263, 265-66 (W.D.N.Y. 1986)

(Curtin, *Ch. J.*) (pre-*Ianniello* and disagreeing with it; abandoned by Judge Curtin in *O'Hara, supra*);
Gerson v. Rapoport, 651 F. Supp. 395, 397-99 (N.D.N.Y. 1987)
(McAvoy, *J.*) (post-*Ianniello* and applying it);
Bankers Trust Co. v. Feldesman, 648 F. Supp. 17, 24-27 (S.D.N.Y. 1986)
(Conner, *J.*) (pre-*Ianniello* and agreeing with its broad construction of "pattern");
Baum v. Phillips, Appel & Walden Inc., 648 F. Supp. 1518, 1533-35 (S.D.N.Y. 1986)
(Leisure, *J.*) (pre-*Ianniello* and disagreeing with it);
Kovian v. Fulton County National Bank and Trust Co., 647 F. Supp. 830, 837-38 (N.D.N.Y. 1986)
(Munson, *Ch. J.*) (pre-*Ianniello* and disagreeing with it);
Carlucci v. Owens-Corning Fiberglass Corp., 646 F. Supp. 1486 (E.D.N.Y. 1986)
(Wexler, *J.*) (pre-*Ianniello* and disagreeing with it);
Beck v. Manufacturers Hanover Trust Co., 645 F. Supp. 675, 683-85 (S.D.N.Y. 1986), *aff'd on other grounds*, 820 F. 2d 46 (2d Cir. 1987)
(Sweet, *J.*) (pre-*Ianniello* and disagreeing with it);
Bear Creek Productions Inc. v. Saleh, 643 F. Supp. 489 (S.D.N.Y. 1986)
(Weinfeld, *J.*) (pre-*Ianniello* and disagreeing with it);
Schaafsma v. Marriner, 641 F. Supp. 576 (D. Vt. 1986)
(Billings, *J.*) (pre-*Ianniello* and disagreeing with it);
Richter v. Sudman, 634 F. Supp. 234, 238-40 (S.D.N.Y. 1986)
(Goettel, *J.*) (pre-*Ianniello* and disagreeing with it);
Soper v. Simmons International, Ltd., 632 F. Supp. 244, 250-55 (S.D.N.Y. 1986)
(Sand, *J.*) (pre-*Ianniello* and disagreeing with it; found by Judge Sand in *In re Gas Reclamation, Inc., supra*, to be rejected by *Ianniello*);

Anisfeld v. Cantor Fitzgerald & Co., Inc., 631 F. Supp. 1461, 1467 (S.D.N.Y. 1986)
(Pollack, *J.*) (pre-*Ianniello* and disagreeing with it);
T. & S. Commodities, Inc. v. Becharas Bros. Coffee Co., No. 86 Civ. 0070 (S.D.N.Y. Oct. 6, 1986)
(Owen, *J.*) (pre-*Ianniello* and disagreeing with it);
James A. Jennings Co., Inc. v. Calgi, No. 85 Civ. 8787 (S.D.N.Y. Sept. 22, 1986)
(Motley, *Ch. J.*) (pre-*Ianniello* and agreeing with it);
Conan Properties, Inc. v. Mattel, Inc., 619 F. Supp. 1167, 1171 (S.D.N.Y. 1985)
(Duffy, *J.*) (pre-*Ianniello* and agreeing with it);

I apologize to any of my district court colleagues whose contribution to this judicial cacophony I may have overlooked. But the point is clear: the contest of the "pattern" requirement is a point of sharp division, even after *Ianniello*, which one would have hoped had settled the issue. *Beck*, of course, is virtually certain to turn this mild chaos into sheer bedlam.

Even in the short time since *Beck* was decided, in fact, this bedlam has begun to emerge, as several district judges have wrestled with the contradictions between this court's precedents. *See Nassau-Suffolk Ice Cream, Inc. v. Integrated Resources, Inc.*, 662 F. Supp. 1499 (S.D.N.Y. 1987) (Pollack, *J.*) (interpreting *Beck* as supporting a "narrow" reading of *Ianniello*, and characterizing the "controlling Second Circuit precedents" as "not totally in unison"), *Guilford Mills v. Torf*, No. 85 Civ. 9473 (S.D.N.Y. June 4, 1987) (Haight, *J.*) (restricting "pattern" by interpreting *Ianniello* narrowly in light of *Beck*); *Goldman v. McMahon, Brafman, Morgan & Co.*, No. 85-2236 (S.D.N.Y. June 17, 1987), and *Solitron Inc. v. McAngus*, No. 86-0486 (S.D.N.Y. June 11, 1987) (Leisure, *J.*) (adopting *Ianniello's* broad reading of pattern and concluding that *Beck* did not narrow *Ianniello*). Obviously, nothing is clear in this area

except the obvious need for definitive and decisive direction from this court, direction that the majority fails to provide.

I would reach the "pattern" issue, and decide it simply on the authority of *Ianniello*, rejecting the distinction between civil and criminal RICO offered by some district judges (but not raised here) as contrary to *Sedima's* teaching that civil RICO, as well as criminal RICO, is to be broadly construed. 105 S. Ct. at 3286. Because the majority does not even reach this issue, but instead decides this case on grounds not raised by the parties and not, in my view, justified by the law, I dissent.

APPENDIX I

OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT IN *TELEVIDEO SYSTEMS V. HEIDENTHAL*, NO. 86-2129 SLIP OP. (9TH CIR. SEPTEMBER 2, 1987)

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

(Argued and Submitted March 10, 1987,
Decided September 2, 1987.)
Docket No. 86-2129

TELEVIDEO SYSTEMS, INC., K. PHILIP HWANG, C. GEMMA HWANG,
Plaintiffs-Appellees,

-v.-

FRED. P. HEIDENTHAL, Individually and d/b/a South Harbor Investors and West Cliff Securities,
Defendant-Appellant.

Before:
FLETCHER, BEEZER and THOMPSON,
Circuit Judges.

Defendant appealed from an order of the United States District Court for the Northern District of California, William A. Ingram, J., which entered default judgment after striking his answer. The Court of Appeals held that: (1) court did not abuse its discretion in striking answer and entering default judgment against defendant

as sanction for perjury during depositions and false pleadings filed with court, and (2) plaintiffs made adequate showing of pattern of racketeering activity. Affirmed.

JOHN S. SIAMAS, Debra S. Belaga and Joseph S. Faber, San Francisco, Cal., for plaintiff TeleVideo Systems, Inc.
ALLEN RUBY, San Jose, Cal., for plaintiffs-appellees.
DAVID VAN HOESEN, San Francisco, Cal. for defendant-appellant.

PER CURIAM:

Appellant, Fred Heidenthal. appeals a default judgment entered against him as a sanction for his perjury during depositions and the false pleadings he filed with the court. The district court struck his answer and allowed the appellees to proceed with proof of their case unopposed. The court entered a judgment in excess of $11,000,000 for securities fraud and violations of the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §§1961 *et seq.* (RICO). We affirm.

FACTS

TeleVideo Systems, Inc. and its principal shareholders brought suit against Heidenthal, a vice-president of the company, for securities fraud and RICO violations after discovering evidence of his substantial fraudulent activities. Heidenthal allegedly participated in the diversion of company funds to several fictitious businesses that he had "created."

In depositions, Heidenthal did not deny orchestrating the diversion of corporate funds. Rather, he claimed that he acted at the behest of Mr. Hwang, the President of TeleVideo, to divert money from TeleVideo for Mr.

Hwang's personal use. Heidenthal testified extensively and in great detail about a pseudo-gambling scheme (playing both sides of a bet) that he used as a vehicle to accomplish the diversion, and about other secret transfers of cash to Hwang. Much of the energy of appellees in preparing their case for trial necessarily was diverted to disproving these allegations.

On the day of trial, Heidenthal appeared in court and filed a written declaration that he had testified falsely in his depositions. Specifically, he admitted that he had not participated in a pseudo-gambling scheme but rather had lost $700,000 of appellees' money in gambling. He also stated that he did not transfer large sums of cash to Hwang. Appellees filed a motion for sanctions and for default judgment on their claims against Heidenthal. The court granted appellees' motion for sanctions. It struck Heidenthal's answer and then proceeded to hear appellees' proof in support of their claims against Heidenthal. At the conclusion of the hearing, the court awarded appellees $3,427,392.60 in actual damages together with $766,630.31 in attorneys fees. It directed that the damage award be trebled and that all stock in TeleVideo acquired by Heidenthal be restored to TeleVideo and that the stock purchase agreement between TeleVideo and Heidenthal be rescinded.

DISCUSSION

I

(1) (2) Appellant claims that the district court abused its discretion in striking his answer and entering a default judgment against him. We disagree. Courts have inherent equitable powers to dismiss actions or enter default judgments for failure to prosecute, contempt of court, or abusive litigation practices. *See Roadway Express, Inc. v.*

Piper, 447 U.S. 752, 764, 100 S. Ct. 2455, 2463, 65 L. Ed. 2d 488 (1980); *Link v. Wabash R.R.*, 370 U.S. 626, 632, 82 S. Ct. 1386, 632, 8 L. Ed. 2d 734 (1962); *United States v. Moss-American, Inc.*, 78 F.R.D. 214, 216 (E.D. Wis. 1978). Although the inherent powers have been criticized as "nebulous" *see Eash v. Riggins Trucking, Inc.*, 757 F. 2d 557, 561 (3d Cir. 1985), they are necessary to enable the judiciary to function. *See Michaelson v. United States*, 266 U.S. 42, 65, 45 S. Ct. 18, 19, 69 L. Ed. 162 (1924) (recognizing the inherent power of the courts to punish for contempts as essential to the administration of justice).

(3) There are limits, however, on the power of courts to impose sanctions. The need for the orderly administration of justice does not permit violations of due process. *See Phoceene Sous Marine, S.A. v. U.S. Phosmarine, Inc.*, 682 F. 2d 802, 805-06 (9th Cir. 1982) (recognizing that willful deceit and conduct utterly inconsistent with the orderly administration of justice would merit the imposition of severe sanctions, but finding that because defendant's deceit—falsely stating that he was too ill to attend trial—was unrelated to the merits of the controversy the sanction was inconsistent with due process); *Securities and Exchange Commission v. Seaboard Corp.*, 666 F. 2d 414, 416-17 (9th Cir. 1982) (finding that a default judgment against the defendant for failure to pay a fine when the defendant had complied with an order to give a deposition was punitive and a violation of due process as the court could not presume that the case lacked merit); *see also Hammond Packing Co. v. Arkansas*, 212 U.S. 322, 349-54, 29 S. Ct. 370, 379-81, 53 L. Ed. 530 (1909) (upholding a default judgment for the defendant's failure to comply with an order to produce documents because the court could presume, from the failure to produce evidence relating directly to the merits of the matter, that the case was lacking in merit); *Hovey v. Elliott*, 167 U.S. 409, 413-14, 17 S. Ct. 841, 843, 42 L. Ed. 215 (1897) (finding that courts may not strike

an answer and enter a default merely to punish a contempt of court unrelated to the merits of the case).

Appellant's elaborate scheme involving perjury clearly qualifies as a willful deceit of the court. Although the perjury occurred before the trial began, it infected all of the pretrial procedures and interfered egregiously with the court's administration of justice. The court sanctioned Heidenthal not only to punish him, but to enable the court to proceed to hear and decide the case untainted by further interference and possible further perjury on the part of Heidenthal.

Appellant argues that a default judgment of this magnitude was far too severe a penalty. He argues that he mitigated the harm by admitting before trial commenced that he had perjured himself; he urges that his confession warrants some favorable consideration and argues that this court should be lenient towards him in order not to deter future perjurers from making such admissions. In other words, appellant believes that his belated candor should be rewarded. In some circumstances we might agree that lesser sanctions would be appropriate where a defendant has admitted his falsehoods and they have not tainted the entire pretrial process. This is not such a case.

Appellant's recantation was not motivated by a desire to repent and set the record straight. Under questioning by the district judge, appellant revealed that even his admission was part of his elaborate scheme to prevail at trial. In answer to the district judge's question as to why he testified falsely in the depositions, appellant responded:

> "[b]ecause I was making sure that I would have him and Phil (Hwang) to the point where they thought they had me by the

> short ones, and they would get me in here and then, when I got in here, I am going straight and tell the truth on everything, and his case is going to crumble apart."

Heidenthal's statement, perhaps the only candid one he makes, reveals that his perjury and the recanting were both orchestrated to reap a tactical advantage. To permit Heidenthal to proceed to trial would have played into Heidenthal's hands and greatly disadvantaged plaintiffs who had planned their strategy and developed their case to respond to Heidenthal's false evidence.

(4) Under the circumstances, the trial court accorded Heidenthal all the process that was his due. The court, proceeding under Rule 55(b)(2) of the Federal Rules of Civil Procedure, determined that a hearing should be held and that the plaintiffs should present in open court their prima facie case showing entitlement to judgment. At the hearing, the court heard substantial testimony and admitted documentary evidence on all of the plaintiffs' claims. Plaintiffs, as part of their presentation, furnished the court with an extensive memorandum that, inter alia, cited the court to the specific exhibits among the voluminous submissions that would support each of their claims. At the conclusion of the hearing the court stated that it was satisfied with proof on all claims with one caveat that it wished to give further consideration to the "RICO case," although it expressed the view that "there is little problem with it." (TR 140). Subsequently, it entered judgment for the plaintiffs on all claims.

Rule 55 gives the court considerable leeway as to what it may require as a prerequisite to the entry of a default

judgment.[1] "The general rule of law is that upon default the factual allegations of the complaint, except those relating to the amount of damages, will be taken as true." (Citations omitted). *Geddes v. United Financial Group*, 559 F. 2d 557, 560 (9th Cir. 1977). The district court exceeded the requirements of the rule by taking extensive evidence on all allegations in the complaint including damages.

In addition to claiming that it was error to enter a default judgment against him, Heidenthal claims, that, in any event, it was error to award damages against him on the RICO claims. Before the district court, he claimed that the court lacked jurisdiction over the RICO claims because of the deficiency in the pleadings in respect to the existence of a pattern of racketeering activity. On appeal, his contention is that there was no substantial evidence that he engaged in a pattern of racketeering activity. Ordinarily, in the context of a default, we would permit the appellant to challenge only the sufficiency of the allegations in the complaint to support the claims of RICO violations, *Danning v. Lavine*, 572 F. 2d 1386 (9th Cir. 1978), and, or course, the evidence in respect to damages. *Geddes*, 559 F. 2d at 560. However, since the court required the plaintiffs to prove a prima facie case, we have reviewed both the averments in the complaint and the evidence adduced at the hearing.

(5) In *Sedima S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 496 n. 14, 105 S. Ct. 3275, 3285 n. 14, 87 L. Ed. 2d 346 (1985), the

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[1] Rule 55(b)(2) in pertinent part reads: "If, in order to enable the court to enter judgment or to carry it into effect, it is necessary to take an account or to determine the amount of damages or to establish the truth of any averment by evidence or to make an investigation of any other matter, the court may conduct such hearings or order such references as it deems necessary and proper ... "

Supreme Court cautioned that, while a "pattern of racketeering activity" must include at least two distinct acts of racketeering,

> [t]he legislative history supports the view that two isolated acts of racketeering activity do not constitute a pattern. As the Senate Report explained: "The target of (RICO) is thus not sporadic activity. The infiltration of legitimate business normally requires more than one 'racketeering activity' and the threat of continuing activity to be effective. It is this factor of continuity plus relationship which combines to produce a pattern" S. Rep. No. 91-617, p. 158 (1969) (emphasis added).

Both TeleVideo's complaint and the evidence presented at the default hearing reveal that Heidenthal engaged in at least thirteen acts of fraud, clearly related, with similar purposes, results, participants, victims, and methods of commission. Because these acts were many, continuous and related, we have no difficulty concluding that a pattern of racketeering activity was pled and a prima facie case established.

AFFIRMED.

APPENDIX J

OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT IN *ALLRIGHT MISSOURI V. BILLETER*, NO. 86-1476, SLIP OP. (8TH CIR. SEPTEMBER 16, 1987)

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

(Submitted April 13, 1987,
Decided September 16, 1987)
Docket Nos. 86-1476, 86-1537

ALLRIGHT MISSOURI, a Missouri corporation, individually and on behalf of Downtown Development Associates, Ltd., a Missouri limited partnership,
Appellant,

-v.-

J. DAVID BILLETER, individually and as general partner of Downtown Development Associates, Ltd., a Missouri limited partnership; ROBERT BLUESTEIN, individually, and as general partner of Downtown Development Associates, Ltd.; JOSEPH E. BURKHARDT, individually, and as general partner of Downtown Development Associates, Ltd. and as general partner of Riverside Hotel Investment, Ltd., a Missouri limited partnership; BENJAMIN ICHINOSE, individually, and as general partner of Downtown Development Associates, Ltd., a Missouri limited

partnership; IRWIN SENTURIA, individually, and as general partner of Downtown Development Associates, Ltd., a Missouri limited partnership; RICHARD H. SENTURIA, individually, and as general partner of Downtown Development Associates, Ltd., a Missouri limited partnership, and as general partner of Riverside Hotel Investment, Ltd., a Missouri limited partnership; COMMNET FINANCIAL SERVICES, INC.; LAWRENCE E. KUDER, in his capacity as Trustee for Savings Investment Service Corporation; CLAYTON G. CARY, JR.; JOHN W. CARY; J. DENNIS CATALANO; RONALD H. FELL; RICHARD H. FENDELL; FIRST KING PROPERTIES, INC.; GAIL K. FISCHMANN; STEPHANIE FRIEDMANN; GUARANTEE ELECTRICAL CO.; ROBERT HANSON and IMOGENE HANSON; HOFFMAN PARTNERSHIP, INC.; E. DEAN JARBOE; JACK K. KRAUSE; DENNIS P. LONG; EUGENE V. RANKIN; SIMON INVESTMENT TRUST; T&M INVESTMENT, INC.; RICHARD S. WEISS; SANFORD W. WEISS; WHARFSIDE REDEVELOPMENT CORPORATION; THE RIVERSIDE AND LANDING PARKING SYSTEM, INC.; BURKHARDT FAMILY TRUST; ROBERT BLUESTEIN and DORA BLUESTEIN; RICHARD H. SENTURIA and ILENE B. SENTURIA,

Appellees.

Before:

LAY, *Chief Judge* and ARNOLD and

WOLLMAN, *Circuit Judges.*

WOLLMAN, Circuit Judge:

Allright Missouri, Inc. (Allright), a Missouri corporation, appeals from a final judgment entered by the district court dismissing its claims against the defendants. In addition, Allright also appeals several interlocutory orders decided adversely to it below. We affirm in part, reverse in part, and remand for further proceedings consistent with this opinion.

Allright is a limited partner in Downtown Development Associates, Ltd. (Downtown), a Missouri limited partnership formed by defendants Joseph Burkhardt and Richard Senturia in 1980 for the purpose of acquiring two city blocks of land located in an area known as Lacledes Landing in downtown St. Louis, Missouri. After the property was acquired, the general partners of Downtown[1] sold units of limited partnership interests in Downtown over the next three years to several individuals and entities.[2] Allright contends that material misrepresentations and omissions of fact were made in the sale of these interests.

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[1] The general partners of Downtown, each of whom has been named as a defendant in this case, are Richard Senturia, Joseph Burkhardt, Irwin Senturia, J. David Billeter, Benjamin Ichinose, and Robert Bluestein.

[2] The limited partners of Downtown are Allright, Clayton Cary, Jr., John Cary, J. Dennis Catalano, Ronald Fell, Richard H. Fendell, First King Properties, Inc., Gail Fischmann, Stephanie Friedmann, Guarantee Electrical Company, Robert Hanson and Imogene Hanson, Hoffman Partnership, Inc., E. Dean Jarboe, Jack K.Krause, Eugene V. Rankin, Simon Investment Trust, T&M Investment, Inc., Richard Weiss, and Sanford Weiss. (Dennis Long had been a limited partner in Downtown but has subsequently renounced any interest he may have had as a limited partner in Downtown.)

In 1984, the general partners proposed a conveyance of approximately 1.3 acres of Downtown's real property to another Missouri limited partnership, Riverside Hotel Investments, Ltd. (Riverside), in exchange for a twenty percent interest in that partnership. Riverside planned to construct a three-hundred room, eight story hotel on the site. Pursuant to the Downtown limited partnership agreement, consent of the majority-in-interest of the limited partners was needed to convey the property to Riverside inasmuch as Burkhardt and Senturia, both general partners of Downtown, initially owned, controlled, and were general partners of Riverside. At or prior to the time that Burkhardt and Senturia solicited the consent of the limited partners, they allegedly told certain limited partners, including Allright, that an additional six million dollars would be invested in Riverside and that Riverside would borrow approximately eighteen million dollars (or roughly seventy-five percent of the construction cost) for the construction of the hotel on the property. The majority-in-interest of the limited partners approved the transaction, and the transfer of the interest in the property to Riverside was completed on or about March 30, 1984. A $23,298,000 loan, secured by a mortgage on the property and by the personal guarantees of the four general partners of Riverside, was obtained from Savings Investment Service Corporation (SISCorp) for the construction of the hotel on the property. Apparently it was only after the transfer of the property to Riverside that the limited partners became aware of the fact that Burkhardt and Senturia never did seek the promised additional capitalization of Riverside and that instead of borrowing only seventy-five percent of the cost of the hotel, nearly one hundred percent of its cost had been borrowed from SISCorp. It is also alleged that only after the conveyance did the limited partners fully learn that Burkhardt and Senturia had paid the sum of $981,000 out of the initial construction loan draw as a permanent loan commitment

fee for a permanent loan commitment that was nonexistent and that Burkhardt and Senturia had assessed Riverside several substantial fees payable to themselves or their affiliates, a significant portion of which was paid out of the initial construction loan draw.

After conveyance of the property, the general partners of Downtown, acting through Burkhardt and Senturia, solicited ratification of the conveyance by the limited partners but were unsuccessful. Between March 29, 1984, and July 5, 1984, Allright allegedly demanded that Downtown's general partners take whatever action necessary to recover the real property conveyed to Riverside or else to recover reasonable compensation from Burkhardt, Senturia, and/or Riverside. The general partners, though, apparently rejected Allright's demands for action.

On June 26, 1984, after construction on the hotel had already begun, Allright filed suit in federal district court, naming all the general partners and the other limited partners of Downtown as defendants. Allright later filed a First Amended Complaint on July 5, 1984, joining the mortgagee, SISCorp. Defendants subsequently moved to dismiss the complaint. Allright responded by filing a ninety-one page, sixteen count Second Amended Complaint. Count I alleged a violation of the Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. §§ 1961-1968 (1982), and sought treble damages against Burkhardt and Senturia; Counts II through VIII alleged a series of violations of federal securities laws and sought rescission of the transfer to Riverside; Counts IX through XI alleged violations of the Missouri securities laws and sought rescission of the conveyance to Riverside. The remaining counts were for breach of fiduciary duty, breach of the partnership agreement, dissolution and accounting, and removal of Senturia as a general

partner of Downtown. Afterwards, twelve of the twenty limited partners filed a cross-claim against the general partners, adopting Allright's claims and adding additional parties and claims.[3] The district court granted defendants' motion to dismiss the federal and Missouri securities law claims on the ground that neither Allright nor the other limited partners had capacity to bring a derivative suit. The court also dismissed the other pendent state law claims without prejudice. Upon defendants' subsequent motion, the district court entered an order dismissing the RICO claim—the only count remaining—finding that Allright had failed to allege sufficient acts for there to be a pattern of racketeering activity under the statute. These appeals followed.

I

Allright's major contention is that the district court erred in ruling that Allright and the other limited partners lacked the capacity to bring their federal and Missouri securities law claims derivatively. We agree.

The starting point for our analysis is Fed. R. Civ. P. 17(b), which states:

> The capacity of an individual, other than one acting in a representative capacity, to sue or be sued shall be determined by the law of the individual's domicile. The capacity of a corporation to sue or be sued shall be determined by the law under which it was organized. In all other cases

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[3] Together with Allright, these limited partners constitute a majority of the limited partnership interests.

> capacity to sue or be sued shall be determined by the law of the state in which the district court is held, except (1) that a partnership or other unincorporated association, which has no such capacity by the law of such state, may sue or be sued in its common name for the purpose of enforcing for or against it a substantive right existing under the Constitution or laws of the United States ... .

Under the plain wording of the rule, we are required to apply state law (Missouri law in this instance) to determine whether the limited partners have the capacity to bring a derivative suit. *See Klebanow v. New York Produce Exch.*, 344 F. 2d 294, 296-97 (2d Cir. 1965); *Engl v. Berg*, 511 F. Supp. 1146, 1152-53 (E.D. Pa. 1981); *Smith v. Bader*, 458 F. Supp. 1184, 1136-87 (S.D.N.Y. 1978). While Missouri courts have not directly spoken on the question, several courts in other jurisdictions have recognized the right of a limited partner to bring a derivative suit. *See, e.g., Klebanow*, 344 F. 2d at 295-99, *Engl*, 511 F. Supp. at 1152-53; *McCully v. Radack*, 27 Md. App. 350, 340 A. 2d 374 (Md. Ct. Spec. App. 1975); *Jaffe v. Harris*, 109 Mich. App. 786, 312 N.W. 2d 381 (1981); *Riviera Congress Assocs. v. Yassky*, 18 N.Y. 2d 540, 223 N.E. 2d 876, 277 N.Y.S. 2d 386 (1966); *Strain v. Seven Hills Assocs.*, 75 A.D. 2d 360, 429 N.Y.S. 2d 424 (1980). These courts have tended to analogize the limited partner to those persons who traditionally have been allowed to institute legal action to protect their interests in property that is under the immediate and direct control of another person. A common analogy is to the corporate shareholder. As stated in *Klebanow:*

> [I]n the main, a limited partner is more like a shareholder, often expecting a share of the profits, subordinated to general creditors,

> having some control over direction of the enterprise by his veto on the admission of new partners, and able to examine books and "have on demand true and full information of all things affecting the partnership ..." *See* N.Y. Partnership Law §§98, 99, 112. That the limited partner is immune to personal liability for partnership debts save for his original investment, is not thought to be an "owner" of partnership property, and does not manage the business may distinguish him from general partners but strengthens his resemblance to the stockholder; and even as to his preference in dissolution, he resembles the preferred stockholder.

344 F. 2d at 297. Another frequent analogy is to a beneficiary of a trust, who under generally recognized principles of law can bring an action on behalf of the trust when the trustee is the malfeasor or has wrongly refused to enforce a claim of the trust against an outsider. *See id.*, 344 F. 2d at 297-99; *Jaffe*, 312 N.W. 2d at 384; *Riviera*, 18 N.Y. 2d at 547-48, 223 N.E. 2d at 879-80, 277 N.Y. S. 2d at 392. A compelling argument is made in these cases that if a corporate shareholder and trust beneficiary can bring a suit on behalf of the corporation or trust when the directors or trustees fail to act or were themselves the wrongdoers, there is no good reason why a limited partner should not be able to bring a suit on behalf of the limited partnership under similar circumstances.

Besides being influenced by the jurisprudence in the related areas of corporations and trusts, the court in *Klebanow* also took note of the fact that a derivative suit provides a "speedier and more effective remedy" for injury to the partnership than the traditional relief

available to the limited partner of dissolution and winding up. 344 F. 2d at 299. The ineffectiveness of the remedy of dissolution is illustrated by the fact that dissolution may force a limited partner to terminate a profitable investment because of the wrongdoing of a general partner; moreover, there may also be several potential tax consequences to a limited partner's taking this route, possibly making it on the whole more costly to dissolve the partnership than to tolerate the wrongdoing. *See* Note, Procedures and Remedies in Limited Partners' Suits for Breach of General Partners Fiduciary Duty, 90 Harv. L. Rev. 763, 765, 774-75 (1977). The other relief available to the limited partner, an action for an accounting of profits, can also be inadequate when there is ongoing malfeasance by management, *id.* at 765, or when the wrongdoing is by non-partners. *See* Hecker, Limited Partners' Derivative Suits Under the Revised Uniform Limited Partnership Act, 33 Vand. L. Rev. 343, 350 (1980). Given the fact that the remedies of dissolution and accounting are incapable of providing effective relief for many of the wrongs that can occur to the limited partners' interest, a more potent mechanism is needed. In our estimation, the derivative suit is such a device.

In arguing under Missouri law Allright and the other limited partners lack standing to bring a derivative suit, defendants refer us to a provision of Missouri's Uniform Limited Partnership Law, Mo. Ann. Stat. §359.260 (Vernon 1968) (repealed, effective January 1, 1989), which states that "[a] contributor, unless he is a general partner, is not a proper party to proceedings by or against a partnership, except where the object is to enforce a limited partner's right against or liability to the partnership." The language of this provision is taken from the Uniform Limited Partnership Act, promulgated in 1916 and adopted in all but one of the fifty states. *See* Hecker, *supra*, at 343, 351-53. Defendants argue that this language

indicates that Missouri did not recognize at the time this suit was filed the right of Allright or the other limited partners to bring a derivative suit. The court in *Klebanow* disarmed a similar attempt to use the same language in a New York statute to bar a derivative suit. 344 F. 2d at 298-99. It found that while this provision could be interpreted as completely prohibiting a derivative suit, it could just as well be construed as intended to eliminate the need to join limited partners in lawsuits where the partnership is involved, and to also provide that ordinarily—but not always—general partners are to control litigation matters. *Id.* at 298. The court found that because New York law was ambiguous on this point, and since a federal right was at stake in the case, it was entitled to decide the matter in a manner that would allow the federal claim to be asserted. *Id.* at 299. State courts have subsequently expanded *Klebanow* and applied it in instances where only state law claims are at issue; these courts have construed this provision, the interpretation of which was admittedly unsettled at the time of the *Klebanow* decision, as not barring limited partner derivative suits. *See, e.g., Jaffe*, 312 N.W. 2d at 383-85; *Riviera*, 18 N.Y. 2d at 547, 223 N.E. 2d at 879, 227 N.Y.S. 2d at 391; *Strain*, 429 N.Y.S. 2d at 427-28. We believe that Missouri courts will adopt the approach taken by these courts.

Defendants further point to the actions—and for that matter inaction—by the Missouri legislature in recent years as an indication that a derivative suit is barred here. Defendants find it significant that although the National Conference of Commissioners on Uniform State Laws incorporated in the Revised Uniform Partnership Act in 1976 a provision permitting limited partner derivative suits, the Missouri legislature did not add this provision when it amended its limited partnership act in 1983. It was not until 1985 that Missouri enacted legislation expressly allowing a limited partner to bring a derivative

suit.[4] (Partnerships formed prior to January, 1987, such as Downtown, have until January 1, 1989, to elect to be governed by the revised act. Mo. Ann. Stat. §359.641 subd. 2 (Vernon Supp. 1987).) We do not find that the delay by the legislature in promulgating this provision can necessarily be construed to mean that Allright cannot bring a derivative suit at this time. A limited partner's right to bring a derivative suit had its origin at the common law, *see Klebanow*, 344 F. 2d at 295-99; we therefore need not find an express legislative grant of authority in order to be able to conclude that Allright can bring this suit. The fact that the Missouri legislature did not promulgate a provision in 1983 expressly allowing this type of suit to be maintained could be interpreted a number of ways. At best, it is unclear whether the legislature actually rejected a provision allowing limited partner derivative suits. Likewise, it is also ambiguous as to what the legislature intended when it eventually did enact such a provision but with language making the provision not immediately controlling on partnerships formed before January 1987. On the one hand, this provision could be interpreted to mean that the legislature intended to bar completely any derivative action by a limited partner in a partnership formed before January 1987, until such partnership elected to be governed by the revised act. On the other, it could just as well be construed to mean that with regard to partnerships formed prior to 1987, any right to bring a derivative suit before the partnership

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[4] Mo. Ann. Stat. §359.571 (Vernon Supp. 1987) states that "[a] limited partner may bring an action in the right of a limited partnership to recover a judgment in its favor if general partners with authority to do so have refused to bring the action or if an effort to cause those general partners to bring the action is not likely to succeed."

elected to be governed by its provisions would have to be derived from the common law, and not from any statutory grant. Because the intent of the Missouri legislature is ambiguous and based on the above-mentioned reasons for allowing a derivative suit—which we believe Missouri courts would find persuasive—we will resolve these ambiguities in favor of allowing a derivative suit to be brought in this instance.

Finally, we would be remiss if we failed to mention that a minority of courts have chosen not to follow the *Klebanow* line of cases, barring at least in some instances a limited partner from bringing a derivative suit. *See, e.g., Browning v. Maurice B. Levien & Co.*, 44 N.C. App. 701, 262 S.E. 2d 355 (N.C. Ct. App.), *appeal denied*, 300 N.C. 371, 267 S.E. 2d 673 (1980); *Fox v. Sackman*, 22 Wash. App. 707, 591 P. 2d 855 (Wash. Ct. App. 1979); *Amsler v. American Home Assurance Co.*, 348 So. 2d 68 (Fla. Dist. Ct. App. 1977), *cert. denied*, 358 So. 2d 128 (1978). Allright attempts to distinguish these cases on the basis that in each the limited partner was seeking to bring a derivative suit not against the general partners (what Allright terms an insider derivative suit), but against third parties (referred to by Allright as an outsider derivative suit). Characterizing its lawsuit as an insider derivative suit since it is principally directed against the general partners of Downtown, Allright argues that the cases denying the limited partner the right to bring suit are inapplicable.[5] While these cases can perhaps be distinguished on factual grounds, we believe the better approach—and the approach the Missouri courts would follow—would be to allow the maintenance of a derivative suit without distinction as to

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[5] But note, however, that an outsider—the mortgagee—is a defendant in this case.

whether it is primarily directed against insiders or third parties. In the related areas of corporations and trusts, suits by shareholders or trust beneficiaries on behalf of the corporation or trust are not barred simply because the defendants in the suit are third parties. *See* Restatement (Second) of Trusts §282 (1959); Mo. Ann. Stat. §507.070 (Vernon 1952) and Mo. R. Civ. P. 52.09 (no special requirements when a shareholder derivative suit is brought against third parties). Also, logic and experience would dictate that a limited partner's investment in the partnership could be harmed just as greatly through the wrongful acts of third parties as it could through the actions of the general partners. As already discussed, other remedies available to the limited partners are often ineffective to remedy the harm caused to the limited partnership and the limited partner's interest therein. The adequacy of these remedies is often no better, and sometimes much worse, when outsiders are the ones guilty of the wrongdoing.

We hold that under Missouri common law Allright has the capacity to bring a limited partner derivative suit on its federal and Missouri securities law claims. We believe that Missouri courts will reject the approach taken by the minority of courts that have declined to allow limited partner derivative suits.[6]

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[6] Our conclusion forecloses the need to address Allright's argument that its federal and state securities law claims are not exclusively derivative.

II

Defendants next argue that even if a limited partner has standing to bring a derivative suit, Allright failed to comply with the requirements of Fed. R. Civ. P. 23.1 and accordingly should not be permitted to maintain this action.[7] The district court did not rule on this contention, we may consider this argument, however, inasmuch as it would provide a basis to affirm the district court's

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[7] Fed. R. Civ. P. 23.1 states in pertinent part:

> In a derivative action brought by one or more shareholders or members to enforce a right of a corporation or of an unincorporated association, the corporation or association having failed to enforce a right which may properly be asserted by it, the complaint shall be verified and shall allege (1) that the plaintiff was a shareholder or member at the time of the transaction of which the plaintiff complains or that the plaintiff's share or membership thereafter devolved on the plaintiff by operation of law, and (2) that the action is not a collusive one to confer jurisdiction on a court of the United States which it would not otherwise have. The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors or comparable authority and, if necessary, from the shareholders or members, and the reasons for the plaintiff's failure to obtain the action or for not making the effort. The derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of the shareholders or members similarly situated in enforcing the right of the corporation or association.

A partnership is an unincorporated association for purposed of Rule 23.1. *See Phillips v. Kula*, 200, 83 F.R.D. 533, 534 (D. Hawaii 1978).

decision. *See Reeder v. Kansas City Bd. of Police Comm'rs*, 733 F. 2d 543, 548 (8th Cir. 1984).

Defendants begin by asserting that Allright did not allege with particularity its efforts to obtain the desired action by the general partners of Downtown. We reject this contention. The demand required by Rule 23.1 serves the purpose of notifying management so that it can make the initial decision as to the type of action that should be taken, be it a lawsuit or some other form of corrective action, to resolve the problem at hand. *Daily Income Fund, Inc. v. Fox*, 464 U.S. 523, 529-33 (1984); *Allison v. General Motors Corp.*, 604 F. Supp. 1106, 1117 (D. Del.), *aff'd* 782 F. 2d 1026 (3d Cir. 1985). At the very least, "a demand must identify the alleged wrongdoers, describe the factual basis of the wrongful acts and the harm caused to the (enterprise), and request remedial relief." *Allison*, 604 F. Supp. at 1117.

In paragraph 30 of its Second Amended Complaint, Allright pleaded the following facts:

(1) Between March 29, 1984, and July 5, 1984, it demanded that the general partners of Downtown take whatever action was necessary to recover Downtown's property or to recover reasonable compensation therefor from defendants Burkhardt, Senturia and/or Riverside;

(2) It reiterated its demands at a meeting for all the general partners and all of the limited partners on May 17, 1984;

(3) No action was taken by the general partners of Downtown; and

(4) Any further action would be futile since four of the six general partners of Downtown will always reject any

demand because they either personally benefitted or are related to general partners who have so benefitted.

Assuming, as we must, that the allegations in Allright's complaint are true, *see Flowers v. Continental Grain Co.*, 775 F. 2d 1051, 1052 n. 2 (8th Cir. 1985), we find that Allright's demand meets the requirement of Rule 23.1. The demand identified the alleged wrongdoers (i.e., Burkhardt and Senturia); described the wrongful act at issue (i.e., the conveyance to Riverside); implicitly denoted the harm caused to the partnership (i.e., implicit in the demand was the fact that there was an improper loss of a valuable partnership asset); and made a request for remedial relief (i.e., a return of the property, or in lieu thereof, reasonable compensation from Burkhardt, Senturia, and/or Riverside). In addition, defendants' position is further weakened by the fact Allright alleged in its complaint the futility of a demand due to the close proximity of the general partners to the alleged impropriety. If a demand would be futile, it need not be made. *See, e.g., Lewis v. Curtis*, 671 F. 2d 779, 784-87 (3d Cir.), *cert. denied*, 459 U.S. 880 (1982).

Defendants also assert that pursuant to Rule 23.1 Allright should have requested prior to filing this action or the Second Amended Complaint that the other limited partners, who by majority vote approved the conveyance, join in its efforts to rescind the sale. Rule 23.1 states that the plaintiff must "allege with particularity the efforts, if any, made by [him] to obtain the action [he] desires from the directors or comparable authority and, if necessary, from the shareholders or members ..." Courts have interpreted the "if necessary" requirement to mean that the necessity of making a demand on the shareholders or members should be governed by the applicable state law. *See Jacobs v. Adams*, 601 F. 2d 176, 179-80 (5th Cir. 1979); *Brody v. Chem. Bank*, 482 F. 2d 1111, 1114 (2d Cir.),

cert. denied, 414 U.S. 1104 (1973); *GA Enters., Inc. v. Leisure Living Communities, Inc.*, 66 F.R.D. 123, 128 (D. Mass. 1974), *aff'd.*, 517 F. 2d 24 (1st Cir. 1975). Although this approach may have merit when the underlying substantive claim is a state law claim, its persuasiveness is weakened when a federal claim is involved, especially when the policy underlying the federal right would be defeated by applying the state shareholder demand requirement. *See* 7C C. Wright, A. Miller & M. Kane, Federal Practice and Procedure §1832 at 122-23 (2d ed. 1986) (when a federal claim is at stake, the state shareholder demand rule should not be applied unless there is some "clear purpose" for doing so). It is clear that under Missouri law a demand must be made in the context of a shareholder derivative suit. *See Wolgin v. Simon*, 722 F. 2d 389, 392 (8th Cir. 1983). Nonetheless, we need not decide today whether Missouri's shareholder demand requirement applies so far as Allright's federal securities law claims are concerned, nor need we decide whether the Missouri shareholder demand requirement will be extended to limited partner derivative suits. Assuming for the sake of argument that the state shareholder demand requirement applies as a general rule to both federal and state claims brought derivatively by a limited partner in federal court, we find that a demand on the limited partners by Allright must be excused since it would be futile in this instance. Missouri courts have imposed this additional requirement to provide an opportunity for shareholder ratification of the allegedly improper act, thereby eliminating the necessity of a lawsuit. *Id.* Here, however, the limited partners have once before refused to ratify the transaction; and the pleadings reveal that a majority-in-interest of the limited partners have adopted Allright's position in this litigation, further evidencing the fact that ratification is a dead letter at this point.

We also reject defendants' assertion that Allright does

not fairly and adequately represent the interests of the limited partners for much the same reason. Defendants argue Allright has an interest adverse to the limited partners because Allright has an option to buy all of Downtown's real property if Allright is successful in frustrating the transfer to Riverside. Defendants once again ignore the fact that a majority-in-interest of the limited partners have openly supported Allright's position in this lawsuit, even to the extent of having Allright argue their position on appeal. At this point it would be disingenuous to say that Allright's position is contrary to that of the other limited partners.

We conclude that Allright has fulfilled the requirements of Rule 23.1 and thus has standing to present its federal and Missouri securities law claims.

III

In Counts II through XI (allegations that federal and state securities laws were violated), Count XIII (an allegation that Downtown's general partners breached the partnership agreement) of Allright's Second Amended Complaint, and in several counts of the cross-claims of the other limited partners of Downtown, Allright and the cross-claimants sought rescission of the conveyance to Riverside. Defendants assert as an alternative ground for upholding the dismissal of these counts that rescission is no longer an appropriate remedy because subsequent to the conveyance of the 1.5 million dollars worth of property to Riverside a twenty-four million dollar hotel was constructed on the land. This argument was the basis for Burkhardt's and Senturia's motion for summary judgment below. The district court did note rule on this motion because its other rulings eliminated the need to do so, but it did indicate that it would have granted the motion had it been necessary to address the issue.

We find that a dismissal of the claims on the basis of the inappropriateness of the requested relief would be premature at this point. First, material factual questions still exist. for example, defendants have argued that Allright should have voiced its discontent with the conveyance to Riverside at an earlier time—either during or prior to the hotel's construction. Allright, however, counters by asserting that no significant construction of the hotel had taken place at the time it first made its demand on the general partners to undo the conveyance and SISCorp. had disbursed only $3,000,000 of the $23,298,000 under the loan and deed of trust (half of which was immediately returned to it in the form of fees).

The ability to obtain restitution is generally dependent on the fact that the underlying circumstances have not materially changed. *See* Restatement of Restitution §142(1) (1937); *American Gen. Ins. Co. v. Equitable Gen. Corp.*, 493 F. Supp. 721, 756 (E. D. Va. 1980) (the premise of the remedy of rescission is "that the parties can be restored to the status quo ante"). The construction of the hotel on the property is clearly a change of circumstance. Nevertheless, a change of circumstances is not a defense to a claim for restitution if "the change occurred after the recipient had knowledge of the facts entitling the other the restitution and had an opportunity to make restitution." *See* Restatement, *supra*, at §142(3); *American Gen.*, 493 F. Supp. at 757-58. A factual question thus exists whether or not defendants proceeded to construct the hotel in disregard of Allright's alleged protests. Furthermore, even if it is found that Allright cannot obtain rescission, it should be able to amend its complaint to request damages. *See* Fed. R. Civ. P. 15(a) (leave is to be freely given by the court when justice so requires so that a party may amend his pleadings). Any decision on the type of relief available is ordinarily made at the end of trial after all of the facts and circumstances have been

fully developed. *See Boggess v. Hogan*, 328 F. Supp. 1048, 1053-54 (N.D. Ill. 1971). Accordingly, summary judgment on the rescission claims would be inappropriate at this time.

IV

Allright contends that the district court erred in dismissing its RICO claim against Burkhardt and Senturia for failure to allege sufficient acts to establish a pattern of racketeering activity. To establish a claim under RICO there must be "(1) conduct (2) of an enterprise (3) through a pattern (4) of racketeering activity." *Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 496 (1985) (footnote omitted). We agree with the district court that a pattern of racketeering activity has not been adequately alleged here.

According to Allright, the following acts by Burkhardt and Senturia, if proven as having occurred in the manner that Allright has alleged, would constitute a pattern of racketeering activity under the Act: (1) acts of mail, wire, and securities fraud in connection with the sale of the limited partnership interests; (2) the wrongful sale of 1.3 acres of Downtown's property to Riverside in exchange for a twenty percent interest in Riverside and wrongful acts relating thereto; and (3) improper diversion of other assets to Burkhardt and Senturia and their affiliates.

We held in *Superior Oil v. Fulmer*, 785 F. 2d 252, 257 (8th Cir. 1986), that something more than a single scheme is required in order to establish a pattern of racketeering

activity.[8] In *Superior Oil*, the defendants had engaged in several acts of fraud relating to the theft of liquid petroleum from Superior Oil's pipeline. *Id.* at 253-54. We found that such acts, amounting to what was deemed to be a single scheme to divert petroleum gas from the pipeline, failed to rise to the level of a pattern of racketeering activity. *Id.* at 257. In the present case, we agree with the district court that only a single scheme is present. Allright's allegations, if true, evince only a solitary scheme by Burkhardt and Senturia to wrongfully deprive the limited partners of their investment in the partnership. The fact that the alleged acts occurred over a number of years (from 1980 to 1984), *see, e.g., Ornest v. Delaware N. Cos.*, 818 F. 2d 651 (8th Cir. 1987); *Deviries v. Prudential-Bache Sec., Inc.*, 805 F. 2d 326, 329 (8th Cir. 1986), or were directed against several individuals and entities comprising the limited partnership interests, does not dissuade us from this conclusion. Accordingly, we hold that under the mandate of *Superior Oil* and its progeny there has not been a sufficient allegation of a RICO violation. Allright's RICO claim was thus properly dismissed.

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[8] While the decision in *Superior Oil* has not been without its critics, *see, e.g., United States v. Ianniello*, 808 F. 2d 184, 192 (2d Cir. 1986), *cert. denied*, 107 S. Ct. 3230 (1987); *Morgan v. Bank of Waukegan*, 804 F. 2d 970, 974-76 (7th Cir. 1986), it remains the law of this circuit. *See, e.g., Henning v. First City of Worthington*, No. 86-5320, slip op. at 5 n. 5 (8th Cir., July 7, 1987); *Madden v. Gluck*, 815 F. 2d 1163, 1164 (8th Cir. 1987) (per curiam), *petition for cert. filed*, 55 U.S.L.W. 3838 (U.S. June 16, 1987) (No. 86-1923). Though Allright does not say so in so many words, for all intents and purposes, it would have us to reverse this circuit's holding in *Superior Oil*. We of course are not at liberty to overrule the decision of a prior panel of this court. *See United States v. Lewellyn*, 723 F. 2d 615, 616 (8th Cir. 1983).

V

The district court held that after its dismissal of the federal and Missouri securities law claims, it was appropriate to dismiss the pendent state claims of Allright and the cross claimant limited partners. Dismissed were Allright's claims (which the other limited partners subsequently adopted) for recovery for breach of the partnership agreement, breach of fiduciary duty, and its claims for equitable relief in the form of dissolution and accounting, and removal of Senturia as a general partner of Downtown.[9] Also dismissed were the other limited partners' claims for recovery from Downtown's general partners for misappropriation of partnership funds, fraud, fraudulent transfer of a portion of Downtown's property, and breach of contract, and their claim for recovery from SISCorp. for its alleged negligence in extending financing to Riverside for the construction of the hotel on the property.

The doctrine of pendent jurisdiction is one of discretion, not of right. *United Mine Workers v. Gibbs*, 383 U.S. 715, 726 (1966). Hence, even if state and federal claims "derive from a common nucleus of operative fact" and are such that a plaintiff "would ordinarily be expected to try them all in one judicial proceeding," a federal court need not in every case permit the state claims to be joined. *Id.*

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[9] Included in Allright's state law claims were its claims under the Missouri securities laws. The district court did not dismiss these counts for lack of pendent jurisdiction because by this time these claims had already been dismissed on the basis that the limited partners lacked the capacity to bring these claims derivatively. As a result of our determination that Allright and the cross-claimants have the capacity to bring these claims, the district court, on remand, must consider whether such claims should be joined under the doctrine of pendent jurisdiction.

at 725-26. Among the factors a court should consider are: the judicial efficiency of trying the claims together; the convenience and fairness to partners; the avoidance of needless questions of state law; the degree to which the state law claims predominate, if at all, over the federal claims; the nexus of the state claims to questions of federal policy; and the risk of jury confusion. *Id.* 726-27. At the time that the district court dismissed the pendent claims, all that remained was the RICO count. The pendent claims were dismissed on the basis that state law issues substantially predominated the case; that such issues were basically collateral to a determination of liability under RICO; and that the risk of jury confusion on the RICO counts would be heightened with the introduction of additional evidence not pertinent to the RICO claim. Having found that Allright has failed to allege sufficient acts to support its RICO claim but that it does have standing to bring its federal securities law claims, we vacate the district court's ruling dismissing the state claims and remand for a further determination regarding the propriety of allowing the state claims to be raised in this suit.

VI

Pursuant to Fed. R. Civ. P. 38(b), a party may request a jury trial as a matter of right "not later than 10 days after the service of the last pleading directed to such issue." Allright and the cross-claimants did not request a jury trial within this time period. Approximately six weeks prior to the date set for the nonjury trial, they did file a motion for a jury trial pursuant to Fed. R. Civ. P. 39(b), which provides that "notwithstanding the failure of a party to demand a jury trial in an action in which such a demand might have been made of right, the court in its discretion upon motion may order a trial by a jury of any or all issues." The motion for a jury trial was made when

only the RICO claim remained. The district court denied the motion, reasoning that: (1) the matters involved in the RICO count were too complex and were not "peculiarly suited to jury determination"; (2) the defendants would be prejudiced because they had prepared their case with a view toward a bench trial and a jury trial would undoubtedly mean additional preparation; and (3) the granting of a jury trial would necessitate the setting of a new trial date when the case had already been on a nonjury docket for over three months. Allright argues that the district court abused its discretion in denying the motion.

Since we find that there was no basis for a RICO claim in the facts alleged by Allright, we obviously need not reach the question of whether a jury trial should have been granted on this count. The circumstances have measurably changed since the time the motion for a jury trial was made. Whether the district court would grant a jury trial under these circumstances we cannot say. We vacate the order denying the motion for jury trial. Allright and the cross-claimants may on remand renew their request, making their argument in light of these changed circumstances. It will be within the sound discretion of the district court to grant or deny this motion.[10]

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[10] Allright also contends that the district court erred in denying several of its discovery requests. We find no abuse of discretion. *See Voegeli v. Lewis*, 568 F. 2d 89, 96 (8th Cir. 1977). Several of Allright's discovery requests called for information outside of the scope of the lawsuit or for information not discoverable under the federal rules absent a showing of compelling need. The other discovery requests were in the form of interrogatories. Although these requests were denied, the district court did permit Allright to depose other individuals who could supply the information Allright sought. Under the circumstances, this was reasonable.

Finally, although the district court did not address this point, Community Investment Services Corporation (Commnet), the transferee of the mortgagee SISCorp,[11] has argued that because Allright and the cross-claimants have failed to state a claim against it, it should be dismissed from the case. Commnet overlooks the fact, though, that pursuant to Fed. R. Civ. P. 19(a) it cannot be dismissed at this time because it is a necessary party. According to Rule 19(a):

> A person who is subject to service of process and whose joinder will not deprive the court of jurisdiction over the subject matter of the action shall be joined as a party in the action if (1) in the person's absence complete relief cannot be accorded among those already parties, or (2) the person claims an interest relating to the subject of the action and is so situated that the disposition of the action in the person's absence may (i) as a practical matter impair or impede the person's ability to protect that interest or (ii) leave any of the persons already parties subject to a substantial risk

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[11] After SISCorp was dismissed from the case by the district court, but before the remaining RICO claim was ultimately dismissed against Burkhardt and Senturia, SISCorp transferred all of its right, title and interest in the mortgage and the debt which it secures to Commnet, a Florida Corporation. Since SISCorp claims no further interest in the note and deed of trust, Commnet has argued in its place in this appeal.

> of incurring double, multiple, or otherwise inconsistent obligations by reason of the claimed interest, if the person has not been so joined, the court shall order that the person be made a party.

Allright and the cross-claimants requested rescission of the conveyance and cancellation of the deed of trust. Obviously, should the district court permit rescission, Commnet must be a party to the case so that complete relief can be granted and so that Commnet would have an opportunity to protect its interests. Moreover, even if other relief is awarded, such as traditional legal damages or rescissional damages, Commnet's interest may also be impaired.

VIII

In conclusion, we reverse the dismissal of the federal and Missouri securities law claims on the basis that Allright and the cross-claimants are entitled to bring a limited partner derivative suit under Missouri law. We affirm the dismissal of the RICO claims and the district court's rulings on Allright's discovery requests. We further hold that the requirements of Fed. R. Civ. P. 23.1 have been met; that dismissal on the ground that rescission is an improper remedy would be premature at this point; and that Commnet, as transferee of the mortgagee, should not be dismissed from the case at this time since it is a necessary party to this litigation. We vacate the dismissal of the state law claims and the district court's denial of Allright's motion for a jury trial and remand for further proceedings in accordance with our resolution of the issues.

This court's mandate shall issue forthwith.

APPENDIX K

OPINION OF THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT IN *HMK CORPORATION V. WALSEY,* NO. 86-3582, SLIP OP. (4TH CIR. SEPTEMBER 17, 1987)

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

(Argued February 2, 1987 Decided September 17, 1987
Docket No. 86-3582

HMK CORPORATION, a Virginia Corporation,

Plaintiff-Appellant,

-v.-

JOHN C. WALSEY; BARRY S. BLUMBERG; SIGMA CJ ASSOCIATES, a Virginia limited partnership; PETULA ASSOCIATES, LTD., an Iowa corporation; JOHN OR JANE DOE ONE THROUGH TEN, persons unknown or as yet unidentified who were employed by or associated with or were predecessors or successors in interest to John C. Walsey, Barry S. Blumberg, Sigma CJ Associates and/or Petula Associates, Ltd., or who were person employed by, or associated with the enterprises identified herein as The Boulders and who were knowing and willing participants, directly or indirectly, in the conduct of such affair; RICHARD L. HEDRICK; STANLEY R. BALDERSON, JR.; JOHN OR JANE DOE ELEVEN THROUGH

TWENTY, persons unknown or as yet unidentified who were persons employed by, or associated with the enterprise identified herein as Chesterfield County Planning Department and who were knowing and willing participants, directly or indirectly, in the conduct of such enterprise's affairs; HAROLD C. KING; JACK S. HODGE; JOHN OR JANE DOE TWENTY-ONE THROUGH THIRTY persons unknown or as yet unidentified who were persons employed by, or associated with the enterprise identified herein as Virginia Department of Highways and Transportation and who were knowing and willing participants, directly or indirectly, in the conduct of such enterprise's affairs,

Defendants-Appellees.

Before:

HALL, PHILLIPS, and WILKINSON,
Circuit Judges.

GEORGE ROBERT BLAKEY (Notre Dame Law School; James G. Harrison; Lawrence D. Diehl; Ray P. Luphold, III; Marks, Stokes & Harrison, P.C. on brief), for appellant.

STEVEN L. MICAS, County Atty. (Jeffrey L. Mincks, Senior Asst. County Atty. on brief); Charles F. Witthoefft (Michael P. Falzone; Hirschler, Fleischler, Weinberg, Cox & Allen; Edward E. Willey, Jr.; Willey & Hall, P.C.; James T. Moore, Senior Asst. Atty. Gen.; John J. Beall, Jr., Senior Asst. Atty. Gen.; Caroline L. Lockerby, Asst. Atty. Gen., on brief), for appellees.

WILKINSON, Circuit Judge:

HMK Corporation, the plaintiff-appellant in this case, bought property on which it intended to build a large mixed use development. The Boulders Development, controlled by defendant-appellees John C. Walsey, et al., borders HMK's property. HMK alleges that the owners of the Boulders Development misled officials of Chesterfield County, Virginia, and the state Department of Highways and Transportation, thereby subverting the county's planning process. The result of this subversion, according to HMK, is that the defendant gained a windfall at HMK's expense. Based on these allegations, HMK sued the owners of Boulders under civil RICO, 18 U.S.C. §1964(c). The district court granted summary judgment to the defendants on several grounds. We do not resolve the problematic grounds addressed by the district court, however, because we hold that HMK has failed to allege a "pattern of racketeering activity" as required by the RICO statute.

I

The HMK property and the Boulders property are located in the "Jahnke-Chippenham Development Area" of Chesterfield County. This area is bounded on the east by Chippenham Parkway, on the north by the Southern railway, on the south by Midlothian Turnpike and the Beaufont Mall shopping center, and on the west by residences. Both developers proposed to develop their properties for a number of purposes, including office space, retail stores, apartments, and hotels. The County approved both the HMK and the Boulders development proposals with some modifications and conditions.

This is the eighth lawsuit in which HMK challenges the legality of decisions made by Chesterfield County affecting HMK's property and the adjacent Boulders property. In addition to six lawsuits in state court, HMK

has earlier sued in federal district court. *HMK Corp. v. County of Chesterfield*, 616 F. Supp. 667 (E.D. Va. 1985). In the present lawsuit, HMK alleges that the defendants and their co-conspirators defrauded the state and local government into granting the Boulders Development numerous benefits and saddling HMK with numerous burdens. These governmental decisions applied mainly to zoning and the related issues of condemnation and highway placement.

In their complaint and its appendices, appellants detail activities on the part of Boulders that allegedly constitute Boulders' scheme to defraud. Appellants contend that this fraudulent scheme consisted of several episodes of racketeering. These episodes span a period of four years. They include a series of misrepresentations, false statements, half-truths, and omissions to neighborhood residents, the county planning board, the Virginia Department of Highways and Transportation, and other state and local government officials. HMK alleges that through these fraudulent means Boulders sought to (1) secure enhanced zoning for the Boulders property, (2) keep the enhanced zoning while avoiding highway expenses by substituting access across HMK's land for the proposed "flyover" access to Chippenham Parkway, (3) obtain additional development capacity for the Boulders property, (4) obtain access across HMK's land by using threats of condemnation to extort a right-of-way from HMK, (5) delay the HMK development to shift the costs of constructing a highway extension to HMK, and (6) limit the zoning awarded to HMK, thereby placing HMK in an inferior position.

HMK argues that by supplying false or misleading information to the government and the public, Boulders committed multiple acts of mail fraud in violation of 18 U.S.C. §1341, wire fraud in violation of 18 U.S.C. §1343,

transportation fraud in violation of 18 U.S.C. §2314, and extortion in violation of 18 U.S.C. §1951. Because the RICO statute defines "racketeering activity" to include all these offenses, *see* 18 U.S.C. §1961(1), HMK argues that the actions of the defendants support numerous claims for treble damages under RICO.

Thus, HMK filed a second lawsuit in federal court. Specifically, HMK pled a violation of 18 U.S.C. §1962(c), which provides:

> It shall be unlawful for any person employed by or associated with any enterprise engaged in, or the activities of which affect, interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity or collection of unlawful debt.

HMK also pled a violation of §1962(d), which makes unlawful any conspiracy to violate RICO.

The district court granted the defendants' motion for summary judgment. *HMK Corp. v. Walsey*, 637 F. Supp. 710 (E.D. Va. 1986). The court ruled that most of the plaintiff's claims were barred for two reasons: first, they had been or could have been raised in the prior litigation, and second, they were time-barred by the state statute of limitations. The court also ruled that the claims that remained must be dismissed because they did not amount to a "pattern of racketeering activity." In reviewing HMK's appeal, we do not reach the issues of res

judicata or the statute of limitations.[1] We hold instead that HMK's allegations in their entirety do not amount to a pattern of racketeering activity, and hence that HMK has not adequately pled a RICO violation.

II

This circuit recently addressed the question of when a pattern of racketeering activity exists in a strictly commercial context. *International Data Bank v. Zepkin*, 812 F. 2d 149 (4th Cir. 1987). That case drew upon the Supreme Court's discussion of the RICO pattern requirement in *Sedima, S.P.R.L. v. Imrex Co., Inc.*, 473 U.S. 479 (1985). In the present case, we address the question of when a RICO pattern exists in a mixed commercial and political context.[2]

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[1] A recent Supreme Court decision invalidates the district court's holding that HMK's action is time-barred by the Virginia statute of limitations. After the district court rendered its decision in this case, the Supreme Court heard argument on and decided the question of the appropriate statute of limitations to apply to RICO civil enforcement actions. In *Agency Holding Corp. v. Malley-Duff & Associates, Inc.*, 107 S. Ct. 2759 (1987), the Court held that the four year federal statute of limitations applicable to Clayton Act actions was the appropriate limitations period for civil RICO actions. *Id.* at 2767. The Supreme Court's decision renders invalid the district court's application of Virginia's one-year "catch-all" limitations period to civil RICO actions. HMK filed its complaint in this case on January 6, 1986. The activity and injuries alleged by HMK occurred within the previous four years. Therefore, HMK's action is not time-barred.

[2] As a preliminary matter, we note that HMK has identified the Chesterfield County Planning Department and the Virginia Department of Highways and Transportation as the enterprises some of the defendants are alleged to have been employed by or associated with. The word "enterprise" in §1962(c) has been broadly construed to encompass units of government as well as commercial entities. *See United States v. Long*, 651 F. 2d 239, 240-41 (4th Cir. 1981)

In *Sedima*, the Court suggested that "[t]he 'extraordinary' uses to which civil RICO has been put" resulted partly from "the failure of Congress and the courts to develop a meaningful concept of 'pattern.'" 473 U.S. at 500. The Court also reviewed the legislative history of RICO in a footnote, intimating that RICO did not target the isolated offender and that the word "Pattern" in the statute means more than sporadic instances of criminal activity. *Id.* at 496 n. 14.

Lower courts responded to the Supreme Court's cue with differing interpretations of the pattern requirement. The Eighth Circuit held that several related instances of mail or wire fraud in pursuit of one continuing fraudulent scheme cannot amount to a pattern. *See Superior Oil v. Fulmer*, 785 F. 2d 252 (8th Cir. 1986). The Second and Eleventh Circuits have continued to emphasize the number of predicate offenses. *United States v. Ianniello*, 808 F. 2d 184 (2d Cir. 1986); *Bank of America v. Touche Ross & Co.*, 782 F. 2d 966 (11th Cir. 1986). The Seventh Circuit held that the existence of a pattern must be determined with regard to all the circumstances of a case, rather than an isolated factor or set of factors. *Morgan v. Bank of Waukegan*, 804 F. 2d 970 (7th Cir. 1986).

Our decision in *Zepkin* elaborated a case-by-case standard akin to that announced by the Seventh Circuit in *Morgan*. Under this standard, the court looks to the "criminal dimension and degree" of the alleged misconduct. *Zepkin*, 812 F. 2d at 155. The misconduct at issue in *Zepkin*, a securities fraud, was held to constitute "a single, limited scheme" and hence was not a pattern of racketeering activity. *Id.*

The existence of a pattern thus depends on context, particularly on the nature of the underlying offenses. Attention to the nature of the underlying offenses is

necessary because the heightened civil and criminal penalties of RICO are reserved for schemes whose scope and persistence set them above the routine. In *Zepkin* we examined the special characteristics of securities fraud in determining whether a pattern existed:

> Without attempting an all-embracing definition of the pattern requirement, we believe that a single, limited fraudulent scheme, such as the misleading prospectus in this case, is not of itself sufficient to satisfy §1961(5). Nor do we find "a pattern" in the fact that one allegedly misleading prospectus reached the hands of ten investors. If the commission of two or more "acts" to perpetrate a single fraud were held to satisfy the RICO statute, then every fraud would constitute "a pattern of racketeering activity." It will be the unusual fraud that does not enlist the mails and wires in its service at least twice. Such an interpretation would thus eliminate the pattern requirement altogether.

812 F. 2d at 154-155.

This same focus on context is consistent with the approach taken by the Seventh Circuit in *Lipin Enterprises v. Lee*, 803 F. 2d 322 (7th Cir. 1986). The Seventh Circuit's later opinion in *Morgan* described how the analysis of the pattern requirement in *Lipin Enterprises* hinged on the characteristics of the dispute, which involved a stock acquisition, and how the pattern requirement could not be interpreted in a manner that would bring every controversy of a particular character within RICO's ambit:

> In *Lipin*, the plaintiff alleged that the

> defendants defrauded him as part of a single acquisition of over $960,000 worth of stock. It is true that plaintiff was able to point to multiple predicate acts: a false statement made during negotiations for the sale, false financial statements, (and) a false opinion letter from the attorneys .... The existence of multiple predicate acts in *Lipin*, however, is only because the acquisition of stock in this context is a complicated transaction that requires many separate statements from a variety of persons: financial statements from the accountants, opinions from the lawyers, oral statements from the parties negotiating the sale, and so forth.

Morgan, 804 F. 2d at 976.

III

In the present case, we must look to the nature of the mixed commercial and political context of a development dispute. One characteristic of such disputes is that they typically require the involvement of many government decision makers at various stages of the approval process. It therefore cannot be sufficient just to point to multiple predicate acts in furtherance of a scheme to influence a development dispute; otherwise, every such dispute could lead to a cause of action under RICO.

Plaintiff HMK, like the plaintiff in *Lipin, supra*, has alleged many predicate acts of fraud. HMK's complaint is accompanied by a 129-page appendix that gives a detailed account of the defendants' alleged scheme to obtain favorable decisions from Chesterfield County in this development dispute. The presence of numerous

predicate acts, however, arises from the complexity of political processes in general, and from those that govern land development in particular.

Virginia law specifies the procedural requirements that must be satisfied in order to amend zoning regulations and classifications. Once a property owner petitions the local governing body or planning commission for a reclassification, the zoning statute provides that before the governing body adopts or approves the proposed amendment, it must be reviewed by the local planning commission. Both bodies must provide public notice and hold public hearings. Once action has been taken on the proposal, parties wishing to contest the decision may seek review in the state circuit court. Va. Code Ann. §§15.1-491, 15.1-493 (1950). *See Vinton v. Falcun Corp.*, 226 Va. 62, 65-66, 306 S.E. 2d 867, 869 (1983). Zoning decisions are complex and require consideration of numerous, important, and often competing, interests and concerns. Local planners and legislators must consider such diverse factors as congestion on public streets, adequacy of police and fire protection, adequacy of transportation, sewage facilities, and water, economic development and employment opportunities, and preservation of historic areas and agricultural and forest lands. *See* Va. Code Ann. §15.1-489 (1950). Such considerations necessarily require the participation of numerous agencies and organizations.

Nothing in HMK's allegations sets this development dispute above any other dogfight between developers. The district court placed this lawsuit, in its proper perspective:

> "Although the parties have filed voluminous briefs and exhibits detailing the history of this case, the Court finds the case

> extraordinarily simple. Two developers have crossed swords over a unified section of land so that advantages given one hamper the aspirations of the other."

HMK Corp., 637 F. Supp. at 711. The fact that a developer must seek multiple permits and approvals does not bring every such controversy within the ambit of RICO. Here the allegations pertain merely to the allocation of burdens and benefits in the development of two adjoining properties. HMK does not allege that the defendants have previously interfered in the county planning process before this development dispute began or that they have done so again in the period since.

In addition to the number of predicate acts, HMK also points to the span of time that the scheme covered—a span of more than four years. Yet the passage of time, like the complexity of the decisionmaking process, is more a reflection of the nature of zoning approvals rather than of the distinctively pervasive nature of the defendants' scheme. In a private, commercial context, the fact that a scheme spans many years might constitute powerful support for the finding of a pattern of racketeering activity. In a mixed commercial and political context such as this one, where interference in the political process is an important part of the alleged scheme, the passage of time may not have comparable significance.

Public bodies often proceed deliberately. The process of zoning approval often involves multiple hearings and opportunity for public comment. These hearings serve to inform public officials, provide a forum for public opinion, and permit landowners adversely affected by the proposed changes to voice their opposition. *See* 1 R. Anderson, American Law of Zoning 235-37 (3rd ed. 1986). This inevitably leads to a protraction of the

administrative process. But such delay is seen as a worthwhile price for the benefits of due process and accurate decisionmaking. An ordinary rezoning decision, not to mention decision involving the location of roadways, housing projects, shopping centers, or office complexes, always has the potential to generate intense public opposition, to implicate several levels of government, and to take time to resolve. We obviously do not intimate that a RICO pattern is impossible in such circumstances. The element of "continuity" necessary for a pattern of racketeering activity under RICO cannot, however, be viewed in a vacuum and apart from the inherent characteristics of the decisionmaking process.

Hence, neither the number of predicate acts nor the span of time elevates the alleged scheme in this case to a pattern of racketeering activity under RICO. The gravamen of HMK's complaint is that its opponents deceived various public bodies to obtain favorable land use decisions on the Jahnke-Chippenham tract. Although we hold that no pattern exists in the present case, we want to make clear that the pattern requirement certainly does not bar all RICO claims arising in the zoning context. Without attempting to rule on cases that are not before us, we note that a plaintiff who alleged pervasive involvement by a developer in the political process through widespread racketeering activity could indeed meet the pattern requirement. Allowing a RICO claim in more routine situations, where a loser in the political arena simply alleges misrepresentations made by the victor, "would undermine Congress's intent that RICO serve as a weapon against ongoing unlawful activities whose scope and persistence pose a special threat the social well-being." *Zepkin*, 812 F. 2d at 155.

In enacting RICO, Congress did not intend to preempt and federalize the field of state business law. Since the federal cause of action does converge, however, with state actions that comprise predicate acts on which RICO is based, some overlap and displacement of state law is inevitable. To recognize a pattern of racketeering activity under these facts, however, would work a wholesale displacement of state authority that Congress never intended.

Congress provided strong measures to ensure compliance with RICO. In addition to the criminal penalties of imprisonment, fines, and forfeitures in §1963, Congress also provided strong incentives to civil enforcement. Section 1964(c) permits persons injured in their business or property by a RICO violation to recover treble damages and costs, including a reasonable attorney's fee. These strong incentives to civil enforcement carry with them the concomitant danger that traditional state causes of action aimed at rectifying individual instances of commercial misconduct will be relegated to a position of secondary importance. Such familiar state causes of action as common law misrepresentation and fraud, unfair trade practices, and wrongful franchise termination, not to mention the general run of commercial and contractual disputes, could be eclipsed or resolved primarily as pendent claims in federal court. To secure access to the federal courts and to recover treble damages and attorney's fees under RICO, litigants may attempt to recast such single, isolated schemes as a "pattern of racketeering activity." *See Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 504-05 (1984) (Marshall, J., dissenting). To permit plaintiffs injured in such schemes to bring their claims under RICO would consign state law to unprecedented federal oversight irrespective of the parties'

citizenship, and would deprive the states of jurisdiction over these local controversies in a way Congress never intended. Congress chose the "pattern requirement" of §1962(a) as the mechanism by which "ordinary claims of fraud best left to 'the state common law of fraud'" are distinguished from those activities of such a "criminal dimension and degree" as to warrant the extraordinary remedies of RICO. *Zepkin*, 812 F. 2d at 155.

In a mixed commercial-political controversy such as this one, vitiation of congressional intent would bring additional adverse consequences. Permitting litigants to sue under RICO after every loss in the legislative arena, based on allegedly fraudulent conduct by the victors, would impinge upon the separation of powers. Permitting a federal suit for fraud in every state of local political squabble would also impinge on the values of federalism to a far greater extent that the Supreme Court has previously allowed.

These values would be affected in important ways. First, such lawsuits would require federal courts to determine whether fraudulent activity was the cause of the local decision for which plaintiff seeks damages. Hence, courts would often have to discount the presumptively legitimate purpose of the decision of a local governing body and attempt to divine its "actual" purpose. Such inquiries into local land use decisions is, of course, required to determine whether stated purposes serve as pretexts for racially invidious intent, but the Supreme Court has noted that inquiries into legislative purpose are otherwise disfavored. *Arlington Heights v. Metropolitan Housing Corp.*, 429 U.S. 252, 265 (1977).

Second, such lawsuits would undermine the finality of legislative decisions. If the losers in every commercial dispute over zoning could routinely sue their opponents

in federal court for fraud, RICO would effect the wholesale transfer of that most basic of local controversies into a federal forum. That result would implicate many of the concerns expressed by this circuit in *Hutchinson v. Miller*, 797 F. 2d 1279, 1285-87 (4th Cir. 1986). In that case, we held that the losing candidate in an election could not recover damages under civil RICO based on allegations of electoral misconduct. We expressed concern over "the continuing assaults on political legitimacy" posed by post-election damage suits brought in federal court by defeated candidates. *Id.* at 1286. Similarly, a RICO lawsuit to contest the methods by which the victors in a zoning fight secured a favorable legislative or administrative outcome would "impair the respect to which the enactments of those duly elected are entitled." *Id.*

V

The RICO statute is not, of course, the only statute or even the primary statute relating to the conduct of developers in land use disputes. State laws, including the laws of Virginia, provide extensive procedures under which developers can contest arbitrary zoning and condemnation decisions. Indeed, HMK vigorously pursued those remedies in its earlier state lawsuits. Federal and state criminal laws provide criminal penalties for fraud, bribery, extortion, and other such offenses. The enhanced civil and criminal remedies of RICO, however, are available only when the conduct at issue amounts to a pattern of racketeering activity.

Because the misconduct that HMK has alleged in this development dispute does not amount to a pattern of racketeering activity, the judgment of the district court is

AFFIRMED.

APPENDIX L

OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT IN *H.J. INC. V. NORTHWESTERN BELL TELEPHONE CO.*, NO. 87-5121, SLIP OP. (8TH CIR. SEPTEMBER 22, 1987)

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

(Submitted September 2, 1987,
Decided September 22, 1987)
Docket No. 87-5121

H.J. INC., a Minnesota corporation, KIRK DAHL, LARRY KRUGEN and MARY KRUGEN, individually and d/b/a Photo Images, SUSAN DAVIS, ROBERT NEAL ISSAC H. WARD, RICHARD L. ANDERSON, THOMAS J. MOTT, and all others similarly situated,

Appellants,

-v.-

NORTHWESTERN BELL TELEPHONE COMPANY, A SUBSIDIARY OF U.S. WEST, A.B.C. individually and D.E.F. as corporations, and other unnamed coconspirators,

Appellees.

Before:

McMILLIAN, Circuit Judge, HENLEY, Senior Circuit Judge, and JOHN R. GIBSON, Circuit Judge.

HENLEY, Senior Circuit Judge:

Plaintiffs appeal from the district court's[1] order dismissing their complaint for failure to state a claim upon which relief could be granted. Fed. R. Civ. P. 12(b)(6); *H.J. Inc. v. Northwestern Bell Telephone Co.*, 648 F. Supp. 419, 430 (D. Minn. 1986). Appellants' complaint alleged, inter alia, violations of the Racketeer Influenced and Corrupt Organizations Act. 18 U.S.C. §§1961-68 (RICO). We affirm.

Because appellants' complaint was dismissed pursuant to Rule 12(b)(6), we view the facts alleged in their complaint in the light most favorable to them. *Bennett v. Berg*, 685 F. 2d 1053, 1057-58 (8th Cir. 1982), *cert. denied*, 464 U.S. 1008 (1983). The gravamen of appellants' complaint is that appellee Northwestern Bell Telephone Company undertook to illegally influence members of the Minnesota Public Utilities Commission (MPUC), the state regulatory body responsible for determining the rates which Northwestern Bell may charge. Appellants claim that Northwestern Bill sought to influence individual MPUC commissioners by various methods including cash gifts, employment offers, tickets to sporting and cultural events, airline tickets, meals and parties. Appellants allege a series of episodes beginning in 1980 and claim the practices continue through the present. The district court dismissed appellants' RICO claims for failure to allege a pattern of racketeering activity. *H.J. Inc.*, 648 F. Supp. at 423-26.

The core requirement for a RICO violation is a pattern of racketeering activity. 18 U.S.C. §1962. *See Sedima, S.P.R.L. v. Imrex Co.*, 105 S. Ct. 3275, 3287 (1985) At the

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[1] The honorable Harry H. McLaughlin, United States District Judge, District of Minnesota.

minimum, at least two acts of racketeering activity[2] are required to establish a pattern. *Sedima*, 105 S. Ct. at 3285 n. 14. However, "while two acts are necessary, they may not be sufficient, indeed, in common parlance two of anything do not generally form a 'Pattern.'" *Id.* Prior to *Sedima* the pattern requirement could be met by simply pleading two acts of racketeering activity. *See Superior Oil Co. v. Fulmer*, 785 F. 2d 252, 255-56 (8th Cir. 1986). In *Sedima* the Supreme Court chastised Congress and the courts for failing to develop a workable definition of "pattern" which would limit the abuse of civil RICO. *Sedima*, 105 S. Ct. at 3287. Accordingly, this circuit has undertaken more meaningfully to construe the concept of "pattern."

We have followed the *Sedima* Court's intimations and have required the combination of continuity plus relationship to establish the necessary pattern. *Superior Oil*, 785 F. 2d at 257. *See Holmberg v. Marrisette*, 800 F. 2d 205, 209-10 (8th Cir. 1986), *cert. denied*, 107 S. Ct. 1953 (1987). "The term 'pattern' itself requires the showing of a relationship ... so, therefore, proof of two acts of racketeering activity, without more, does not establish a pattern ... ." 116 Cong. Rec. 18940 (1970) (statement of Sen. McClellan), *quoted in Sedima*, 105 S. Ct. at 3285 n. 14. The relationship prong is met when two or more racketeering acts are shown to be in pursuit of the same overarching scheme. *See Holmberg*, 800 F. 2d at 210; *Superior Oil*, 785 F. 2d at 257. The district court found that appellants' complaint satisfied the relationship prong. *H.J. Inc.*, 648 F. Supp. at 425. We agree.

The burden of establishing the continuity prong has

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[2] "Racketeering activity" has been defined to include a broad range of criminal offenses. 18 U.S.C. §1961(1)

proven more onerous. "The target of (RICO) is ... not sporadic activity. The infiltration of legitimate business normally requires more than one 'racketeering activity' and the threat of continuing activity to be effective. It is this factor of continuity plus relationship which combines to produce a pattern." S. Rep. No. 91-617, p. 158 (1969), *quoted in Sedima*, 105 S. Ct. 3285 n. 14. In order to demonstrate the necessary continuity appellants must allege that Northwestern Bell "had engaged in similar endeavors in the past or that [it was] engaged in other criminal activities." *Deviries v. Prudential-Bache Securities, Inc.*, 805 F. 2d 326, 329 (8th Cir. 1986). A single fraudulent effort or scheme is insufficient. *Id. See also Ornest v. Delaware North Cos.*, 818 F. 2d 651, 652 (8th Cir. 1987) (single to defraud plaintiffs of sales scheme over eight years commissions); *Madden v. Gluck*, 815 F. 2d 1163, 1164 (8th Cir. 1987) (defendant engaged in a vast array of fraudulent activities in pursuit of a single goal to keep a company afloat in order to loot it). Appellants' complaint alleges no more than a series of fraudulent acts "committed in furtherance of a single scheme to influence MPUC commissioners ... ." *H.J. Inc.*, 648 F. Supp. at 425.

The district court did not err in finding that appellants' complaint failed to satisfy the continuity prong as articulated in this circuit.[3] Therefore, because dismissal was appropriate under Rule 12(b)(6), we do not address

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[3] We are aware that our continuity plus relationship approach to the pattern requirement is not without criticism. *See Sun Savings & Loan Association v. Dierdorff*, No. 86-5811, 56 U.S.L.W. 2110 (9th Cir. Aug. 7, 1987); *United States v. Ianniello*, 808 F. 2d 184, 192 (2d Cir. 1986).

the other issues raised in this appeal. The decision of the district court is affirmed.[4]

McMILLIAN, Circuit Judge, concurring:

I fully concur in the decision to affirm the district court's dismissal of the complaint for failure to satisfy the continuity prong of the pattern of racketeering test adopted by this circuit. I write separately only to state that I agree with Judge John R. Gibson that we should reconsider our pattern of racketeering test, in light of the contrary positions recently taken by several other circuits.

JOHN R. GIBSON, Circuit Judge, concurring:

I concur in the court's opinion because I am satisfied that this result is compelled by our earlier cases commencing with *Superior Oil Co. v. Fulmer*, 785 F. 2d 252 (8th Cir. 1986). In *Henning v. First Bank of Worthington*, No. 86-5320 (8th Cir. July 7, 1987), I concurred separately and expressed by view that the multiple scheme requirement that we have grafted onto the pattern element strays from the statutory language of RICO. The Second and Seventh Circuits, and now the Ninth Circuit, as well as numerous district courts and a respected scholar in this field, have

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[4] Appellants also allege in their complaint pendent state law claims which were dismissed by the district court when the basis for the pendent jurisdiction (the RICO claim) was dismissed. At oral argument the court was advised that state court proceedings had been or were to be initiated. We, of course, do not reach any such claims in this opinion.

criticized our position.[1]

I believe, as stated in my separate concurrence in *Henning*, that when a proper case arises the multiple scheme requirement should be examined by the court en banc.

[1] *See Henning, supra*, footnote 5, and *Sun Savings & Loan Assn. v. Dierdorff*, No. 86-5811, 56 U.S.L.W. 2110 (9th Cir. Aug. 7, 1987)